Supreme Court, U.S.
FILED

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No.

In The

Supreme Court of the United States

October Term, 1997

RUSSELL McLAUGHLIN, JR. and MARK McLAUGHLIN,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Does 26 U.S.C. § 7201 create but a single criminal offense of tax evasion, or are different elements required for evasion of payment and evasion of assessment prosecutions?

2. Does the IRS violate the statutory procedures set out in 26 U.S.C. § 7609 and the taxpayers' privacy interests if it causes a specified third-party recordkeeper (accountant, attorney, bank, stockbroker, etc.) to informally surrender the taxpayers' records without the required summons and notice to the taxpayers?

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Petitioners, Russell McLaughlin, Jr. and Mark McLaughlin, respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit entered in the above-entitled proceeding on September 11, 1997 (App. at 7a), and as to which rehearing and rehearing in banc were denied by that Court on December 3, 1997 (App. at 2a).

OPINIONS BELOW

The opinions below are attached:

1. Opinion of the District Court (on pretrial motions) (App. at 46a) is reported at 1996 U.S. Dist. LEXIS 12983.

2. Opinion of the District Court (on post trial motions) (App. at 36a) is reported at 910 F. Supp. 1054 (E.D. Pa. 1995).

3. Opinion of the Court of Appeals (App. at 7a) is reported at 126 F.3d 130 (3d Cir. 1997).

STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was entered on September 11, 1997 (App. at 7a). Petitioners herein filed a timely petition for rehearing and rehearing in banc as to two issues which the Court of Appeals denied on December 3, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (App. at 2a).

STATUTORY PROVISIONS INVOLVED

Section 7201 of Title 26 provides, in pertinent part, that:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the

payment thereof shall, in addition to other penalties provided by law, be guilty of a felony.

Section 7602 of Title 26 provides, in pertinent part, that:

(a) Authority to summon, etc. — For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized —

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

(b) Purpose may include inquiry into offense. — The purposes for which the Secretary may take any action described in (1), (2) or (3) of subsection (a) include

the purpose of inquiring into any offense connected with the administration or enforcement of the internal revenue laws.

Section 7609 of Title 26 provides, in pertinent part, that:

(a) Notice. —

(1) In general. — If —

(A) any summons described in subsection (c) is served on any person who is a third-party recordkeeper, and

(B) the summons requires the production of any portion of records made or kept of the business transactions or affairs of any person (other than the person summoned) who is identified in the description of the records contained in the summons,

then notice of the summons shall be given to any person so identified within 3 days of the day on which such service is made, but no later than the 23rd day before the day fixed in the summons as the day upon which such records are to be examined. Such notice shall be accompanied by a copy of the summons which has been served and shall contain an explanation of the right under subsection (b)(2) to bring a proceeding to quash the summons.

(2) Sufficiency of notice. — Such notice shall be sufficient if, on or before such third day, such notice is served in the manner provided in section 7603 (relating

to service of summons) upon the person entitled to notice, or is mailed by certified or registered mail to the last known address of such person, or, in the absence of a last known address, is left with the person summoned. If such notice is mailed, it shall be sufficient if mailed to the last known address of the person entitled to notice or, in the case of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, to the last known address of the fiduciary of such person, even if such person or fiduciary is then deceased, under a legal disability, or no longer in existence.

(3) Third-party recordkeeper defined. — For purposes of this subsection, the term "third-party recordkeeper" means —

(A) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law, any bank (as defined in section 581), or any credit union (within the meaning of section 501(c)(14)(A));

(B) any consumer reporting agency (as defined under section 603(d) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f));

(C) any person extending credit through the use of credit cards or similar devices;

(D) any broker (as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4));

(E) any attorney;

(F) any accountant;

(G) any barter exchange (as defined in section 6045(c)(3)); and

(H) any regulated investment company (as defined in section 851) and any agent of such regulated investment company when acting as an agent thereof.

(4) Exceptions. — Paragraph (1) shall not apply to any summons —

(A) served on the person with respect to whose liability the summons is issued, or any officer or employee of such person,

(B) to determine whether or not records of the business transactions or affairs of an identified person have been made or kept, or

(5) Nature of summons. — Any summons to which this subsection applies (and any summons in aid of collection described in subsection (c)(2)(B)) shall identify the taxpayer to whom the summons relates or the other person to whom the records pertain and shall provide such other information as will enable the person summoned to locate the records required under the summons.

(b) Right to intervene; right to proceeding to quash. —

(1) Intervention. — Notwithstanding any other law or rule of law, any person who is entitled to notice of a summons under subsection (a) shall have the right to intervene in any proceeding with respect to the enforcement of such summons under section 7604.

(2) Proceeding to quash. —

(A) In general. — Notwithstanding any other law or rule of law, any person who is entitled to notice of a summons under section (a) shall have the right to begin a proceeding to quash such summons not later than the 20th day after the day such notice is given in the manner provided in subsection (a)(2). In any such proceeding, the Secretary may seek to compel compliance with the summons.

(B) Requirement of notice to person summoned and to Secretary. — If any person begins a proceeding under subparagraph (A) with respect to any summons, not later than the close of the 20-day period referred to in subparagraph (A) such person shall mail by registered or certified mail a copy of the petition to the person summoned and to such office as the Secretary may direct in the notice referred to in subsection (a)(1).

(C) Intervention; etc. Notwithstanding any other law or rule of law, the person summoned shall have the right to intervene in any proceeding under subparagraph (A). Such person shall be bound by the decision

in such proceeding (whether or not the person intervenes in such proceeding).

(c) Summons to which section applies. —

(1) In general. — Except as provided in paragraph (2), a summons is described in this subsection if it is issued under paragraph (2) of section 7602(a) or under section 6420(e)(2), 6421(g)(2), or 6427(j)(2) and requires the production of records.

(2) Exceptions. — A summons shall not be treated as described in this subsection if —

(A) it is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution described in subsection (a)(3)(A), or

(B) it is in aid of the collection of —

(i) the liability of any person against whom an assessment has been made or judgment rendered, or

(ii) the liability at law or in equity of any transferee of fiduciary of any person referred to in clause (I).

(3) Records; certain related testimony. — For purposes of this section —

(A) the term "records" includes books, papers, or other data, and

(B) a summons requiring the giving of testimony relating to records shall be treated as a summons requiring the production of such records.

(d) Restriction of examination of records. — No examination of any records required to be produced under a summons as to which notice is required under subsection (a) may be made —

(1) before the close of the 23rd day after the day notice with respect to the summons is given in the manner provided in subsection (a)(2), or

(2) where a proceeding under subsection (b)(2)(A) was begun within the 20-day period referred to in such subsection and the requirements of subsection (b)(2)(B) have been met, except in accordance with an order of the court having jurisdiction of such proceeding or with the consent of the person beginning the proceeding to quash.

[exerpted]

(g) Special exception for certain summonses. — In the case of any summons described in subsection (c), the provisions of subsections (a)(1) and (b) shall not apply if, upon petition by the Secretary, the court determines, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records.

(h) Jurisdiction of district court; etc. —

(1) Jurisdiction. — The United States district court for the district within which the person to be summoned resides or is found shall have jurisdiction to hear and determine any proceeding brought under subsection (b)(2), (f) or (g). An order denying the petition shall be deemed a final order which may be appealed.

(2) Special rule for proceedings under subsections (f) and (g). — The determinations required to be made under subsections (f) and (g) shall be made ex parte and shall be made solely on the petition and supporting affidavits.

STATEMENT OF THE CASE

Petitioners Russell McLaughlin, Jr. and Mark McLaughlin ("Petitioners") owned Building Inspection Underwriters ("BIU"), a corporation that conducted building inspections for various municipalities in New Jersey and Pennsylvania. In 1995, Petitioners were indicted on charges of conspiracy to defraud the IRS (Count One), evasion of payment of income tax in violation of 26 U.S.C. § 7201 (Count Two) and Russell McLaughlin, Jr. was charged with filing a false tax return in connection with the 1988 return of BIU in violation of 26 U.S.C. § 7206(1) (Count Three). A Superseding Indictment was filed on May 11, 1995 which added their sister Robin McLaughlin as a defendant (App. at 63a).

The jurisdiction of the district court was thus invoked under 18 U.S.C. § 3231 which grants the district courts of the United States original jurisdiction, exclusive of the courts of the States, of all offenses against the laws of the United States.

In a pretrial motion, the defense sought suppression of records taken from the Petitioners' accountant without a summons but

with the accountant's permission. The district court denied the motion (App. at 52a).

At trial before a jury, both Petitioners were convicted of income tax evasion in violation of 26 U.S.C. § 7201. Russell McLaughlin, Jr. was also convicted of subscribing and filing a false 1988 income tax return for BIU in violation of 26 U.S.C. § 7206(1). Each was found not guilty of conspiracy to defraud the IRS. Robin McLaughlin was found not guilty.

Following the denial of post trial motions (App. at 36a)[1], each Petitioner was sentenced to two years in prison and a fine of $100,000.

On appeal, a panel of the Court of Appeals for the Third Circuit granted Russell McLaughlin, Jr. a new trial and vacated the sentence of Mark McLaughlin on grounds that are unrelated to the issues at bar.[2] The court then remanded for a new trial and resentencing, respectively, as to Russell McLaughlin and Mark McLaughlin. As to the two issues at bar, the panel rejected Petitioners' claims. The court subsequently denied Petitioners' Petition for Rehearing and Rehearing In Banc.

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1. The case had been initially assigned to the Honorable J. William Ditter who decided the pretrial motions (App. at 46a). The case was then assigned to the Honorable Robert S. Gawthrop, III who presided at trial, decided the post trial motions (App. at 36a) and imposed sentence.

2. Russell McLaughlin was granted a new trial on the ground that the district court erred in permitting the jury to learn that he had produced certain corporate records in response to a summons, in violation of the principle established in *Braswell v. United States*, 487 U.S. 99 (1988) (App. at 10a-16a). The case against Mark McLaughlin was remanded for resentencing in light of the finding by the court of appeals that the sentencing court erred in imposing a two level upward adjustment under the sentencing guidelines for obstruction of justice under § 3C1.1 based upon his trial testimony (App. at 24a -28a).

As to the tax evasion issue raised in this petition, Petitioners argued the following in the court of appeals: (1) Count Two of the Superseding Indictment unambiguously charged evasion of payment of taxes as the offense under 26 U.S.C. § 7201; (2) the crime of evasion of payment of taxes requires proof of a pre-existing assessment or other ascertainment of the tax due and owing; and (3) the government failed to offer any proof of such a pre-existing assessment. Accordingly, Petitioners contended there was a failure of proof resulting in insufficient evidence to support Count Two of the Superseding Indictment.

The Court of Appeals acknowledged that § 7201 includes two distinct offenses: evading payment and evading assessment and that each offense required different elements of proof (App. at 17a). Furthermore, the panel affirmed that evasion of payment requires proof of a valid assessment from which a defendant hid assets (*id.*). The panel found, however, that Petitioners had sufficient notice from the entire indictment that the Government intended to proceed against them on an evasion-of-assessment theory (*id.*). As such, the Court of Appeals declined to grant relief on that ground.

As to the claim that the IRS failed to comply with the summons and notice requirements of 26 U.S.C. § 7609, prior to their trial and convictions, Petitioners sought suppression on the ground that the IRS agent obtained financial documents from Petitioners' accountant, Melvin Cherry, without first issuing a Summons (App. at 18a-20a). The court held no constitutional or statutory violation occurred because Petitioners voluntarily provided their records to Cherry in order for him to use in the preparation of their tax returns, which would be viewed by others, and therefore Petitioners had no legitimate expectation of privacy in them (App. at 19a). The court of appeals reasoned that the general authority of the IRS to examine books and records provided for in 26 U.S.C. § 7602(a)(1) was not limited by the requirements of 26 U.S.C. § 7609 when the investigating agent was voluntarily given the records by the third-party recordkeeper without recourse to a summons (*id.*).

REASONS FOR GRANTING THE WRIT

I.

THE WRIT SHOULD BE GRANTED TO PERMIT THE COURT TO DECIDE WHETHER 26 U.S.C. § 7201 CREATES BUT A SINGLE CRIMINAL OFFENSE OF TAX EVASION, OR ARE DIFFERENT ELEMENTS REQUIRED FOR EVASION OF PAYMENT AND EVASION OF ASSESSMENT PROSECUTIONS?

A. Introduction

It is respectfully submitted that the Court should grant the petition in order to consider the issue of whether or not the evasion of payment of taxes prosecuted under the tax evasion statute (26 U.S.C. § 7201) requires proof of a pre-existing tax assessment or other liquidation of the tax due and owing, an element not required for conviction on an evasion of assessment theory. The court below held that evasion of payment under § 7201 does require a pre-existing assessment or other liquidation of tax liability, an element not required for evasion of assessment prosecutions under the same statute. However, notwithstanding that holding, the court of appeals construed the indictment in this case to charge both evasion of payment and evasion of assessment, a result which may not obtain if, as the court held, the two violations require proof of different elements.

B. Background of Tax Evasion Prosecutions

The federal tax evasion statute provides, in pertinent part, that:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony.

26 U.S.C. § 7201 (emphasis added).

This Court has held that the elements of a § 7201 violation are willfulness; the existence of a tax deficiency; and an affirmative act constituting an evasion or attempted evasion of the tax. *Sansone v. United States*, 380 U.S. 343, 351 (1963).

This Court recognized in *Sansone* that "Section 7201 includes the offense of willfully attempting to evade or defeat the *assessment* of a tax as well as the offense of willfully attempting to evade or defeat *payment* of a tax." 380 U.S. 354 (emphasis in the original). *Sansone* did not, however, explicitly address the question of whether two separate criminal violations are found within § 7201, requiring different elements, or whether the tax evasion statute simply could be violated in two different ways. In the thirty-three years since the *Sansone* decision, a split in the circuits has ripened, culminating in the decision of the court below.

Prosecutions under § 7201 may involve evasion of the assessment itself, based upon efforts to evade and defeat the ability of the IRS to make an assessment in the first instance. *See United States v. Mal*, 942 F.2d 682, 688 (evasion of assessment generally involves efforts to prevent or deter the government from determining tax liability prior to an assessment). In *United States v. Habig*, 390 U.S. 222 (1968), the defendant attempted to evade assessment of tax by filing a false tax return was convicted of filing a false tax return. This Court has suggested other typical examples of conduct constituting evasion of assessment, to include keeping a double set of books, destruction of books or records and concealment of assets or covering sources of income. *Spies v. United States*, 317 U.S. 492, 499 (1943). *See also United States v. Dack*, 747 F.2d 1172, 1174 (7th Cir. 1984) (defendant failed to file a tax return prior to the filing of a tax assessment). While conceptually these two species of tax prosecutions are fairly clearly defined in case law, there is a clear split in authority among the circuits on whether different elements are required for prosecution.

Ordinarily, an evasion of payment theory is predicated upon the existence of such an ascertained tax liability where the evasion

of payment conduct is designed to place assets beyond the government's reach after the tax liability has been assessed. *United States v. Mal*, 942 F.2d 682, 687 (9th Cir. 1991). For example, a taxpayer who is the subject of an earlier assessment may take steps to place assets beyond the reach of the I.R.S. The law reasons that overt acts of evasion taken with the purpose and consequence of putting assets beyond the ability of the I.R.S. to collect constitutes an attempt to evade and defeat the tax, as defined in the statute. *See United States v. Hogan*, 861 F.2d 312 (1st Cir. 1988) (defendant was convicted of evasion of payment under § 7201 based on defendant's filing of fraudulent withholding allowance certificates thereby avoiding any withholding from his paycheck, and his failure to file tax return); *United States v. Conley*, 826 F.2d 551, 556-58 (7th Cir. 1987) (defendant convicted of evasion of payment under § 7201 concealed nature, extent and ownership of assets by placing assets and property in names of others and transacting his business in cash); *United States v. Voorhees*, 685 F.2d 710 (9th Cir. 1981) (evasion of payment by liquidating assets and placing them beyond the reach of the IRS); *Cohen v. United States*, 297 F.2d 760, 762 (9th Cir.), *cert. denied*, 379 U.S. 865 (1962) (defendant evaded payment of taxes under § 7201 by receiving income in the form of loans, placing his assets in the name of others, and causing monies paid to him to be paid through and in the name of others); *United States v. Hook*, 781 F.2d 1166 (6th Cir.), *cert. denied*, 479 U.S. (1986).

The distinction between evasion of assessment and evasion of payment is critical since evasion of payment "involves conduct designed to place assets beyond the government's reach after a tax has been evaded." *United States v. McGill*, 964 F.2d 222, 230 (3d Cir.), *cert. denied*, 506 U.S. 1023 (1992), *quoting United States v. Mal*, *supra*, 942 F.2d at 687. *See also United States v. Daniel*, 956 F.2d 540 (6th Cir. 1992).

Another distinction between the two kinds of prosecutions under § 7201 has been recognized in at least the third circuit,

dealing with the sequencing required for the overt acts of evasion required under *Spies v. United States*, 317 U.S. 492 (1943). In *United States v. McGill, supra*, the Third Circuit required that, where an indictment charges evasion of payment as having taken place on or after a given date, the affirmative acts of evasion must be proved to have taken place after that date. *Id.* at 231-232. This ruling was reiterated by the Third Circuit more recently in *United States v. Voigt*, 89 F.3d 1050 (3d Cir. 1996). In *Voigt*, the court stated that the failure to include a "pre-deficiency" in the indictment precluded the government from relying on overt acts of evasion predating the existence of the deficiency. A sequencing requirement in the context of an evasion of payment prosecution has, to Petitioners' knowledge, never been applied in an evasion of an assessment decision. Moreover, no circuit has followed or even addressed the issue of sequencing of acts of evasion in an evasion of payment setting.

The court below squarely held that a tax evasion prosecution by way of an evasion of payment theory requires as a separate element proof of a pre-existing liquidation of the tax due and owing or an assessment of the tax due and owing. In the decision in this case, the lower court expressly held that "[h]ad the government charged the McLaughlins with evasion of payment, it would have had to prove a valid assessment from which the McLaughlins hid assets." (App.at 17a).

Of course, in this case, there was no pre-existing assessment and, as a result, the Petitioners contend that there was a complete failure of proof.

C. Factors Supporting the Granting of the Petition

1. There is a Split in the Circuits on the Element of an Assessment

There is a split in the circuits on whether or not an evasion of payment prosecution requires proof that the taxes be shown to

have been previously ascertained by assessment, examination or the taxpayer or by operation of law on the date the return is due and, accordingly, it is submitted that this Court should grant review.

On the one hand, there are those courts holding that evasion of payment does require proof of an assessment. In the decision of the court below, it was squarely held that an evasion of payment prosecution requires proof of a pre-existing assessment or other liquidation of the tax due and owing:

> Section 7201 includes two distinct offenses: evading assessment and evading payment. Those offenses require *different elements* of proof . . . but they frequently overlap.
>
> Had the government charged the McLaughlins with evasion of payment, it would have had to *prove a valid assessment* from which the McLaughlins hid assets.

(App. at 17a) (citations omitted) (emphasis added).[3] Moreover, the court of appeals in this case read its prior decision involving an evasion of payment prosecution, *United States v. McGill, supra,* to encompass the same holding.

While the court construed the indictment in this case to be sufficiently broad so as to include an evasion of payment theory, the holding that an additional element is required alone mandates that this Court grant review to consider the issue. In *United States v. England*, 347 F.2d 425, 430 (7th Cir. 1965), the seventh circuit held that an evasion of payment theory required a pre-existing assessment.[4] In its decision in this case, the Third Circuit cited *United States v. England* to stand for this very holding.

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3. In the decision below, the Third Circuit construed its earlier decision in *United States v. McGill, supra,* to require proof of a separate element consisting of an assessment in an evasion of payment case.

4. *United States v. England* was decided shortly after the Court's decision in *Sansone* but does not discuss *Sansone* in its analysis.

Other courts have apparently assumed that a prosecution based upon an evasion of payment theory requires or at least ordinarily includes proof of a pre-existing deficiency. *See United States v. Hogan*, 861 F.2d 312, 315 (1st Cir. 1988); *United States v. Dack*, 747 F.2d 1172, 1174 (7th Cir. 1984).

On the other hand, several courts have held that different elements are not required. In each such instance, indictment language charging both prongs under § 7201 were attacked on duplicity grounds and in each instance, that attack was rejected. *See United States v. Mal, supra*, 942 F.2d 686; *United States v. Dunkel*, 900 F.2d 105, 107 (7th Cir. 1990), *ruling on remand*, 927 F.2d 955, 956 (7th Cir. 1981); *United States v. Masat*, 896 F.2d 88, 91 (5th Cir. 1990). These cases stand for the proposition that there are no differences in the elements between evasion of payment and evasion of assessment since in each case, the court held that but a single offense was charged in the count in question.

If different elements are required, the indictment count has duplicity problems. Moreover, if different elements are required, the double jeopardy implications of joinder in one count become confusing. For example, a defendant may not know where double jeopardy starts and stops if one indictment count can include both offenses since a double jeopardy analysis depends on whether one additional element is required. *See United States v. Blockburger*, 234 U.S. 229 (1932). The court of appeal's decision thus should be reviewed in order to resolve the inconsistency between permitting inclusion of both kinds of offenses in a single count, when the lower court plainly holds that different elements are required, in light of normal pleading rules, and the implications of the double jeopardy clause.

The manner in which the court of appeals resolved the appeal in this case is evidence of the need for this Court to clarify the issue of what elements are needed and what language is necessary to adequately charge the two species of tax evasion. The court of

appeals held that the indictment language in this case was sufficiently broad to include evasion of assessment as the operative prosecution theory (App. at 18a). This holding stretches the language of the indictment (which plainly sounds in evasion of "payment," using that very language) well beyond the breaking point. Of greater systemic importance, it illustrates the need to clarify the issue at hand.

The court below interpreted the indictment to allege an evasion of assessment theory notwithstanding clear language sounding in evasion of payment:

> On or about March 15, 1989, in the Eastern District of Pennsylvania, [the defendants] willfully attempted to *evade and defeat the payment* of a large part of the income tax due and owing by Building Inspection Underwriters, Inc. (BIU) to the United States for the calendar year 1988, by concealing and attempting to conceal from BIU's accountant and the Internal Revenue Service the nature and extent of BIU's income and the location thereof, and by making false statements to BIU's accountant with respect to the nature and extent of BIU's income.
>
> In violation of Title 26, United States Code, Section 7201.

(App. at 72a) (emphasis added). The indictment plainly alleges an attempt to defeat the "payment" of the tax and the overt acts of evasion sound primarily in that theory. Under no circumstances could the overt acts of evasion be construed to sound solely in an evasion of assessment theory. The language of the evasion count in this case is identical to the language in *United States v. McGill, supra*, a prior third circuit decision which that Court characterized as an evasion of payment case.[5]

5. The *McGill* indictment charged that the defendant "did willfully attempt to evade and defeat the payment of a large part of the income tax due and owing." 964 F.2d at 230, n.19.

Moreover, the analysis of the court below was further flawed when it considered it to be a mere "variance" analysis. Whether or not it was "clear at the start of trial that the Government was proceeding on an evasion of assessment theory," as the lower court stated, the Petitioners raise a far more elemental and constitutional claim.

Relying upon the due process clause and the right to be indicted by decision of a grand jury, the defendants cited *Dunn v. United States*, 442 U.S. 100 (1979), for the proposition that the courts are "not free to revise the basis on which a defendant is convicted simply because the same result would likely obtain on retrial." The court noted that "it is as much a violation of due process to send an accused to prison following a conviction on which he was never tried as it would be to convict him upon a charge that was never made." 442 U.S. at 107. Similarly, in *Stirone v. United States*, 361 U.S. 212 (1960), the defendant was charged with a Hobbs Act violation which, according to the indictment, was based on interference with shipments of sand in interstate commerce. The jury was instructed that it could convict based on either the interference with shipments of sand or shipments of steel. Reversing the conviction, this Court reiterated the rule that "a court cannot permit a defendant to be tried on charges that are not made in the indictment against him." 361 U.S. at 218.

Accordingly, it is submitted that the indictment in this case plainly charged as evasion of payment and that the lower court erred in construing its language to the contrary. The language of the indictment and the lower court's interpretation of that language provide all the more reason why this Court should grant review. If different elements are required for evasion of payment and evasion of assessment, inclusion of both offenses within one count renders the court duplicitous and plainly improper. The lack of clarity and uniformity in the elements of the offenses thus manifests itself at the pleading stage.

A final example of how the lack of clarity in the interpretation of the tax evasion statute manifests itself is the Third Circuit's holdings on sequencing of overt acts of evasion and the assessment or the "on or about date," normally the date of the tax deficiency. If, as Petitioners contend, a pre-existing assessment or other liquidation of the tax due and owing is required for an evasion of payment case, logic suggests that the overt acts of evasion must come after the date of the assessment. This line of reasoning was advanced by the defendant in *United States v. McGill, supra.* and again in *United States v. Voigt, supra.* In each case, the Third Circuit declined to reach the issue since it determined that it need not do so. In each case, the court held, however, that the overt acts of evasion in an evasion of payment case must come after the "on or about" date. In *United States v McGill*, the court declined to reach the issue because the indictment in question limited the overt acts of evasion to the period after the date of the assessment of the deficiencies. 964 F.2d at 230. In *United States v. Voigt*, the structure of the indictment was identical to the *McGill* indictment and the court once again concluded that it need not reach the issue. 89 F.3d at 1088. But for the language in those cases, the Third Circuit would be confronted with implication of its holding that the government would have to prove an assessment from which the petitioners hid assets (by implication, through overt acts of evasion coming after the assessment).

2. Interpretation of the Tax Evasion Statute has Systemic Implications for the Administration of the Tax Laws and the Criminal Justice System

It is submitted that the lower court's decision and the uncertainty on the question presented have grave implications for the administration of justice. The court has not had occasion to squarely analyze the tax theories of evasion-of-payment and evasion-of-assessment in a context such as this one in which the ramifications of its decisions on elements could be considered in light of pleading rules, double jeopardy standards and the over all administration of justice.

It is submitted that the lower court's decision should be reexamined in order to provide guidance to the district courts which are called upon to rule on motions to dismiss and instruct juries on the elements of the offense. Evasion of payment cases are, at least as measured by reported decisions, becoming increasingly common.

The issue is particularly important in light of the context of the question — the administration of the tax laws. Uniformity of policy and decision are particularly significant because of the importance accomplishing national uniformity and predictability in an area of such great importance to the nation.

Accordingly, the Petitioners submit that the lower court's decision should be reexamined in light of its systemically important implications for the administration of criminal justice and the tax laws and to give this Court an opportunity to grapple with the differences between types of tax evasion.

II.

THE COURT SHOULD GRANT THE PETITION TO CONSIDER WHETHER THE IRS VIOLATES THE STATUTORY PROCEDURES SET OUT IN 26 U.S.C. § 7609 AND THE TAXPAYERS' PRIVACY INTERESTS IF IT CAUSES A SPECIFIED THIRD-PARTY RECORDKEEPER (ACCOUNTANT, ATTORNEY, BANK, STOCKBROKER, ETC.) TO INFORMALLY SURRENDER THE TAXPAYERS' RECORDS WITHOUT THE REQUIRED SUMMONS AND NOTICE TO THE TAXPAYERS?

A. Introduction

The Internal Revenue Service interviewed BIU's former accountant and received records from him without first issuing a Summons, and giving the McLaughlins notice of the Service's

request for records in accordance with 26 U.S.C. § 7609(a). The taking of the records was in the earliest stage of the investigation and those records informed much of what followed in the investigation. Petitioners moved to suppress the evidence in the district court and, on appeal, pressed the claim that the I.R.S.'s failure to issue a summons and give notice violated 26 U.S.C. § 7609(a)[6].

The court below rejected Petitioners' claim that § 7609 required the application of this notice procedure, reasoning that the I.R.S. has broad discretion on how it conducts its investigations and, pointing to § 7602(a)(1), has authority to use various means to accomplish the accumulation of information and documents. Section 7602(a)(1) provides the general authority to develop investigative leads, including an informal and non-compulsory means of inquiry. Then, the panel believed, if informal and non-compulsory means are inadequate, §§ 7602(a)(2) and 7602(a)(3) provide mechanisms for the form of compulsion of testimony. Op. at p. 11, *quoting Speck v. United States*, 59 F.3d 106, 108 (9th Cir. 1995).

B. Legal Discussion

The lower court concluded that the authority under § 7602 to gain access to records on an informal basis was not abrogated, modified or limited by the enactment of § 7609 in 1976. It is submitted that § 7609, establishing a comprehensive regime for the issuance of summonses to third-party recordkeepers, provides the sole means by which the I.R.S. may gain access and custody of such records. It has been observed that "Section 7609 itself provides stringent requirements under which the I.R.S. may issue Summonses and obtain books and records concerning a taxpayer from a third-party recordkeeper." *Neece v. Internal Revenue Service*, 922 F.2d 573, 575 n.4 (10th Cir. 1990). The *Neece* court further observed that Congress

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6. The district court rejected the claim.

> enacted § 7609 in 1976, after becoming concerned with the I.R.S.'s uncontrolled and excessive access to taxpayers' records held by third parties, in an effort to protect taxpayers' privacy rights from unnecessary infringement during the course of I.R.S. investigations.

922 F.2d at 575 n.4 *citing H.R. Rep. No. 658, 94th Cong., 2d Sess. 307, reprinted in 1977 U.S. Code Cong. Amend. News 2897, 3203.* The I.R.S. has also enacted regulations which "flesh out" the procedures in question. *See* I.R.S. Regulations, Section 301.7609-1, entitled "Special Procedures for Third-Party Summonses."

Section 7609(a)(1) provides, however, that if a summons is issued to such a "third-party recordkeeper," a copy of the summons must be provided to any person identified in the description of the records sought and such person has a right to intervene. A "third-party recordkeeper," is defined to include an accountant. § 7609(a)(3)(F).

It is submitted that the only reasonable interpretation of § 7609 is that a summons must be issued in order for records to be taken into the custody of the I.R.S. agent, and such is the holding in *Neece v. Internal Revenue Service, supra.* If the Internal Revenue Service could circumvent the notice requirements of § 7609, its procedural protection, clearly designed to protect against government overreaching, would be rendered a nullity. Simply put, the government could take custody of records by other means, resorting to the issuance of a Summons only when it needs to do so, thus depriving persons with an interest in the records of an opportunity to be heard or even to learn that the records are being requested. Indeed, as the *Neece* court pointed out, § 7602(a)(1) only authorizes the I.R.S. to "examine" the books and records and provides no guidance, and implicitly, no authority, as to how the I.R.S. can obtain custody of the records.

Moreover, the legislative history of § 7609 makes clear that Congress was concerned with protecting the privacy and interest of taxpayers "from unnecessary infringement during the course of I.R.S. investigations." *Neece v. Internal Revenue Service, supra*, 922 F.2d at 576 n.4. Legislative history makes clear that Congress did not intend to permit the violations of taxpayers' privacy rights to take place through informal access. Senator Haskell, Chairman of the Senate Subcommittee which, in 1976, reported amendments to the provisions of the Internal Revenue Code, including § 7609, testified as follows:

> Mr. Haskell. Mr. President, I rise to briefly clarify a point raised about a provision in the tax bill, H.R. 10612, which we have just passed. The provision in question, Sec. 1205 restricts the use of administrative summons by the IRS to gain access to records held by third parties, such as banks, brokers, lawyers, and accountants.
>
> The question which has been raised is whether these rules are the exclusive method of access to these records or whether the IRS can avoid these rules and get the records by informal access without any type of summons.
>
> As chairman of the Administrative Subcommittee of the Finance Committee, I studied this issue in depth. Senator Dole, the ranking Republican on the subcommittee, and I proposed the provision to the committee and it was adopted.
>
> We heard much testimony on the abuses of taxpayer's rights by the IRS in various situations. As a result, the tax bill contains many administrative provisions designed to protect the taxpayers' rights and privacy and limit the unbridled power of the IRS to examine a

> taxpayer's records. In the future, the use of an administrative summons will require the person whose records are sought to have notice and the opportunity to object and require the more formal processes of a court-ordered summons. We drew these strict rules to protect the right of privacy that we felt every citizen expects, and rightfully so, in their personal bank records, lawyer's files, et cetera.
>
> At no time did we discuss the questions of allowing informal access to these records without a summons of any sort. We carefully defined the safeguards and spelled out several extraordinary situations in which these procedures can be avoided where they might jeopardize an investigation or the safety of a witness. *It seems to me absurd to suggest that the Congress would act so clearly to protect citizens from the processes of an agency and make those protections optional binding only when the agency chose.*

127 Cong. Rec. 34772 (1976) (Comments of Sen. Haskell, Chairman, Administrative Subcommittee of Senate Finance Committee.) (Emphasis added).[7]

There is, of course, the issue of the appropriate remedy. Guidance can be drawn from the decision in *Lord v. Kelley*, 223 F. Supp. 684 (D. Mass. 1963). There, an I.R.S. agent used coercive tactics to procure possession of tax records from the taxpayer's accountant. *Id.* at 687. Finding a Fourth Amendment violation in the unlawful acquisition of the records, the district court concluded that the records should be returned to the taxpayer, concluding, in essence, that their request in a formal legal proceeding for such

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7. In *United States v. Mobil Corporation*, 543 F. Supp. 507 (N.D. Tex. 1981). In reliance upon Senator Haskell's testimony, the district court concluded that informal access under another section of the IRC (26 U.S.C. § 6001) was not permissible.

return was the equivalent of a motion under 41(e) of the Federal Rules of Criminal Procedure. However, without foreclosing the issuance of a later Summons, the court concluded that the government could make no evidentiary use of the records while they were in the custody of the Internal Revenue Service agents. While *Lord v. Kelley* is not a recent case, its reasoning has been approved more recently in *United States v. Finucan*, 708 F.2d 838 (1st Cir. 1983), a case in which state agents unlawfully seized materials from a defendant's home. *Id.* at 841. Suppressing the records in question, and finding that the inevitable discovery rule did not provide a safety valve for the government, the court adopted the reasoning of the district court in *Lord v. Kelley*.[8]

C. Factors Supporting the Granting of the Petition

1. The Decision of the Lower Court is Inconsistent with an Act of Congress

Congressional motivations for the enactment of § 7609 are clear on the face of the statute and in the legislative history. The interpretation of the Court below, that the IRS may examine such third-party records informally without compliance with § 7609, permits the IRS to do indirectly what it is forbidden to do directly. It eliminates the protection Congress crafted in order to protect privacy rights.

2. There is a Split in the Circuits in the Interpretation of the Interplay Between §§ 7602 and 7609

In the decision below, the Third Circuit ruled that § 7609 did not establish a mandatory procedure required for access to records

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8. A final matter is the question of the defendants' standing, since the records are records of BIU, and other entities. It is clear that a corporate officer or employee may assert a reasonable or legitimate expectation of privacy in its corporate office. *United States v. Chuang*, 897 F.2d 646, 649 (2d Cir.), *cert. denied*, 498 U.S. 824 (1990).

of specified third-parties, holding that the general authority of the IRS to examine books and records provided in § 7602(a)(1) was not modified by § 7609, at least to the extent the records were voluntarily made available without the issuance of a summons.[9]

In *Neece v. Internal Revenue Service, supra,* the Tenth Circuit reached a contrary interpretation of the interplay between § 7602 and § 7609. In that case, a bank voluntarily turned over taxpayers' records to the IRS and the taxpayers sued the bank under the Right to Financial Privacy Act ("RFPA") (12 U.S.C. §§ 3401-3422). The IRS argued that it was informally permitted to review the records under 26 U.S.C. § 7602 and sought to bring its conduct within an exclusion within RFPA which permitted disclosure of records "in accordance with procedures authorized" by the Internal Revenue Code. The Tenth Circuit rejected the argument, concluding that § 7602(a)(1) permitted the review of records in general, § 7609 required compliance with its own notice requirements whether or not a summons is issued. *Id.* at 576. Thus, the *Neece* court expressly rejected the position of the Third Circuit that § 7602(a)(1) grants general authority to review records and take informal possession not subject to the requirements of § 7609.

The position of the Tenth Circuit was adopted by the Ninth Circuit in *United States v. Kao*, 81 F.3d 114 (9th Cir. 1996). In that case, the IRS sought to enforce summonses requesting that the taxpayers execute certain consent directives authorizing banks to disclose records regarding the taxpayers' activities. The IRS argued that it need not comply with § 7609 because summons enforcement to compel the execution of the consent directives was not subject to § 7609. On the basis of the reasoning of the *Neece*

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9. The court below cited *Speck v. United States*, 59 F.3d 106, 108 (9th Cir. 1995) for support of its conclusion that § 7609 does not limit the general grant of authority in § 7602(a)(1). However, *Speck* is readily distinguishable since in that case the records sought through informal means were not in the custody of third-parties specified in § 7609. Rather, the records were those of employees/contractors.

court, the Ninth Circuit rejected this position. It held that to permit the IRS to invoke its powers under § 7602 without regard to § 7609 would leave the protection congress enacted in § 7609 "eviscerated." *Id.* at 117.

In *Raikos v. Bloomfield State Bank*, 703 F. Supp. 1365 (S.D. Ind. 1989), a case squarely on point, the IRS received copies of the taxpayer's bank records through informal request. The taxpayer brought suit under the Right to Financial Privacy Act on claim that the bank turned over the records without notice to him. *Id.* at 1376. After a detailed consideration of the legislative history of § 7609 and the statutory structures of that section and § 7602, the court concluded that congress did not intend that § 7609 limit the ability of the IRS to make informal examinations or take informal custody of records. *Id.* at 1370-72.

There exists a split therefore between the position of the third circuit (and the district court in *Raikos v. Bloomfield State Bank*) and that of the Ninth and Tenth Circuits on the question of whether the IRS may invoke its powers under § 7602(a)(1) in order to circumvent the protections of § 7609.

3. The Application of Section 7609 is of Systemic Importance

At any given time, there are hundreds and perhaps thousands of investigations underway, often involving requests for records from third-party recordkeepers specified in § 7609. The impact of uncertainty in the interplay between the specific language of § 7609 and the general grant of authority in § 7602 is great. It is critical that the Court clarify the procedures to be followed in connection with third-party summonses to attorneys, accountants, banks and other parties subject to that section's coverage.

CONCLUSION

It is respectfully submitted that the Court should grant the writ of certiorari.

Respectfully submitted:

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APPENDIX

APPENDIX A — SUR PETITION FOR PANEL REHEARING WITH SUGGESTION FOR REHEARING IN BANC BEFORE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED DECEMBER 3, 1997

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 96-1982 and 96-2000

UNITED STATES OF AMERICA

v.

RUSSELL McLAUGHLIN, JR.,

Appellant in No. 96-1982

(D.C. No. 95-cr-00113-1)

UNITED STATES OF AMERICA

v.

MARK McLAUGHLIN,

Appellant in No. 96-2000

(D.C. No. 95-cr-00113-2)

Present: SLOVITER, *Chief Judge,*
BECKER, STAPLETON, MANSMANN, GREENBERG,
SCIRICA, COWEN, NYGAARD, ALITO, ROTH,
LEWIS, McKEE, *Circuit Judges,*
and SCHWARZER,* *Senior District Judge.*

*As to panel rehearing only.

Appendix A

SUR PETITION FOR PANEL REHEARING
WITH SUGGESTION FOR REHEARING IN BANC

The petition for rehearing filed by appellants having been submitted to the judges who participated in the decision of this Court, and to all the other available circuit judges in active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is DENIED.

BY THE COURT:

s/
Circuit Judge

DATED: DEC 3, 1997

APPENDIX B — SUR PETITION FOR PANEL REHEARING WITH SUGGESTION FOR REHEARING IN BANC BEFORE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED DECEMBER 3, 1997

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 96-1982

UNITED STATES OF AMERICA

v.

RUSSELL McLAUGHLIN, JR.,

Appellant.

(D.C. No. 95-cr-00113-1)

Before: BECKER, SCIRICA, *Circuit Judges,*
and SCHWARZER,* *Senior District Judge.*

SUR PETITION FOR PANEL REHEARING WITH SUGGESTION FOR REHEARING IN BANC

The petition for rehearing filed by Appellee United States of America having been submitted to the judges who participated in the decision of this court and no judge who concurred in the decision having asked for rehearing, the petition for panel rehearing is DENIED.

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* Honorable William W Schwarzer, Senior United States District Judge for the Northern District of California, sitting by designation.

Appendix B

BY THE COURT:

s/
Circuit Judge

DATED: DEC 3, 1997

APPENDIX C — JUDGMENT OF UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED SEPTEMBER 11, 1997

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 96-1982 and 96-2000

UNITED STATES OF AMERICA

v.

RUSSELL McLAUGHLIN, JR.,

Appellant in No. 96-1982

(D.C. No. 95-cr-00113-1)

UNITED STATES OF AMERICA

v.

MARK McLAUGHLIN,

Appellant in No. 96-2000

(D.C. No. 95-cr-00113-2)

On Appeal from the United States District Court
for the Eastern District of Pennsylvania

Present: BECKER, SCIRICA, *Circuit Judges,*
and SCHWARZER, *Senior District Judge.**

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* Honorable William W. Schwarzer, Senior United States District Judge for the Northern District of California, sitting by designation.

Appendix C

JUDGMENT

These causes came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and were argued by counsel on June 2, 1997.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgments of the said District Court entered October 23, 1996, be, and the same, are vacated. With respect to Russell McLaughlin the cause is remanded to the District Court for a new trial. As to Mark McLaughlin, the cause is remanded to the District Court for resentencing. All of the above in accordance with the opinion of this Court.

ATTEST:

s/
Acting Clerk

Dated: September 11, 1997

Certified as a true copy and issued in lieu
of a formal mandate on December 11, 1997

Teste: s/ P. Douglas Sisk

Clerk, United States Court of Appeals
for the Third Circuit

APPENDIX D — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED SEPTEMBER 11, 1997

UNITED STATES OF AMERICA v. RUSSELL McLAUGHLIN, JR., Appellant in No. 96-1982; UNITED STATES OF AMERICA v. MARK McLAUGHLIN, Appellant in No. 96-2000

Nos. 96-1982, 96-2000

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

126 F.3d 130; 1997 U.S. App. LEXIS 26257; 80 A.F.T.R.2d (P-H) 6436

June 2, 1997, Argued

September 11, 1997, Filed

PRIOR HISTORY:

On Appeal from the United States District Court for the Eastern District of Pennsylvania. (D.C. No. 95-cr00113-1), (D.C. No. 95-cr-00113-2).

DISPOSITION: Russell McLaughlin, Jr.'s convictions VACATED and REMANDED for a new trial. Mark McLaughlin's sentence VACATED and REMANDED for resentencing.

* * *

Appendix D

JUDGES: Before: BECKER, SCIRICA, Circuit Judges, and SCHWARZER,* Senior District Judge. BECKER, Circuit Judge, concurring.

OPINION BY: William W. Schwarzer

OPINION:

OPINION OF THE COURT

SCHWARZER, Senior District Judge

Russell and Mark McLaughlin (the McLaughlins") appeal from their convictions and sentences for income tax evasion. The McLaughlins and their relatives own Building Inspection Underwriters ("BIU"), a close corporation that conducts building inspections for various New Jersey and Pennsylvania municipalities. Russell was president of BIU, and Mark was an officer of the corporation. In 1988, BIU opened two bank accounts, one with New Jersey National Bank ("NJNB") and the other with First Fidelity Bank ("First Fidelity"). During 1988, over $ 700,000 in corporate receipts was deposited in each of those accounts. Neither BIU nor the McLaughlins declared the roughly $ 1,400,000 deposited in the accounts as income on BIU's 1988 federal tax returns.

Both McLaughlins were convicted of attempting to evade assessment of BIU's 1988 income taxes in violation of *26 U.S.C. § 7201.* Russell was also convicted of subscribing and filing a false 1988 income tax return on behalf of BIU in violation of

* Honorable William W. Schwarzer, Senior United States District Judge for the Northern District of California, sitting by designation.

26 U.S.C. § 7206(1). They were acquitted of conspiring to defraud the United States. See *18 U.S.C. § 371.* The McLaughlins were sentenced on the basis of an adjusted offense level of 17. The district court sentenced them both to twenty-four months in custody and three years supervised release and fined each $ 100,000.

The district court had jurisdiction under *18 U.S.C. § 3231,* and we have jurisdiction under *28 U.S.C. § 1291.*

I. APPLICATION OF THE FIFTH AMENDMENT PRIVILEGE TO NONPRODUCTION OF SUBPOENAED DOCUMENTS.

In 1989, the IRS served a summons on Russell, in his capacity as BIU's corporate custodian, requesting production of certain financial records. At trial, the government was permitted to show that Russell produced records and that the production did not include any record of the NJNB account. The government was also allowed to argue that this omission was evidence of intentional evasion of tax assessment.[1]

Russell contends that admission of this evidence violated his Fifth Amendment privilege against self-incrimination. Relying on *Braswell v. United States, 487 U.S. 99, 101 L. Ed. 2d 98,108 S. Ct. 2284 (1988),* he argues that because he

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1. Count One of the Indictment (the conspiracy count) specifically referred to Russell's failure in responding to the summons to disclose to the IRS the NJNB account and to provide books and records concerning it. Count Two inferentially referred to Russell's nonproduction by charging him with concealing . . . from the Internal Revenue Service the . . . location [of BIU income]."

produced corporate records under compulsion of a subpoena directed to him as corporate custodian, see *Baltimore v. Bouknight, 493 U.S. 549, 555-56, 107 L. Ed. 2d 992, 110 S. Ct. 900 (1990)* (quoting *Fisher v. United States, 425 U.S. 391, 411,48 L. Ed. 2d 39, 96 S. Ct. 1569 (1976)): Bellis v. United States, 417 U.S. 85, 40 L. Ed. 2d 678, 94 S. Ct. 2179(1974): Wilson v. United States, 221 U.S. 361, 55 L. Ed. 771,31 S. Ct. 538 (1911); Hale v. Henkel, 201 U.S. 43, 50 L. Ed. 652,26 S. Ct. 370 (1906),* the Fifth Amendment's Self Incrimination Clause barred the government from offering evidence of his personal failure to comply adequately with the subpoena. Russell raised the objection in a motion in limine, which the district court denied by a definitive ruling 'with no suggestion that it would reconsider the matter at trial.' " *Government of V.I.. v. Joseph, 27 V.I. 389, 964 F.2d 1380, 1385 (3d Cir. 1992)* (citing *American Home Assur. Co. v. Sunshine Supermarket, Inc., 753 F.2d 321, 325 (3d Cir. 1985)).* Thus, the issue is properly before us, see *United States v. Mejia-Alarcon, 995 F.2d 982, 986 (10th Cir. 1993)* (citing *American Home, 753 F.2d at 324-25),* and we exercise plenary review. See *In re Grand Jury Subpoena, 957 F.2d 807, 809 (11th Cir. 1992).*

A. Existence of Testimonial Privilege

"Because the act of complying with [a] government [subpoena] testifies to the existence, possession, or authenticity of the things produced," such production may implicate Fifth Amendment rights. *Bouknight, 493 U.S. at 555; Fisher, 425 U.S. at 410; Curcio v. United States, 354 U.S. 118, 125, 1 L. Ed. 2d 1225, 77 S. Ct. 1145 (1957).* Since a corporate custodian produces documents in his representative rather than his personal capacity, he may not invoke his right against self-incrimination

in order to resist a subpoena for corporate records.[2] *Hale, 201 U.S. at 69-70.* Thus, in Braswell, the Court wrote that:

> The government conceded, as it must, that it may make no evidentiary use of the "individual act" against the individual. . . . The Government may not introduce into evidence . . . that the subpoena was served upon and the corporation's documents were delivered by one particular individual, the

2. Judge Becker expresses concern over the application of agency principles to situations such as this case. However, when the government serves a subpoena on a person as corporate custodian, it designates that person to serve as the corporation's agent. *Braswell, 487 U.S. at 118 n.11* ("[A] corporate custodian acts as an agent and not an individual when he produces corporate records in response to a subpoena addressed to him in his representative capacity."). The government could hardly contend, after it has received a response and to circumvent Braswell, that in some particular respect, the custodian was not acting as corporate agent. If the custodian acts negligently, or even dishonestly, he is no less acting in the course of that agency, even If a claim may lie against him for malfeasance. It could, of course, be that a person served with a subpoena is not authorized to produce corporate documents, in which case he is not acting as corporate custodian and all bets are off: a former employee, for example, who produces purloined corporate documents is obviously not within the scope of the Braswell rule. But we do not go behind the assertion of the Fifth Amendment privilege in other situations to ensure that the claim is legitimate-to do so would obviously undermine the privilege. The attack on the "devious custodian" or the "non-producing custodian" is by way of contempt proceedings, not by an examination into his "agency" or the legitimacy of his personal Fifth Amendment privilege. In sum, the outcome is perfectly symmetrical—the corporate custodian qua custodian must comply with a records subpoena and the government is barred from offering the testimonial and incriminating aspects of that production (including non-production) against him.

> custodian. . . . Because the jury is not told that the defendant produced the records, any nexus between the defendant and the documents results solely from the corporation's act of production and other evidence in the case.

487 U.S. at 118.

The government contends that Braswell does not apply here because Braswell concerned production of documents rather than their nonproduction. The distinction is without a difference. The government's concession in Braswell that it may make no evidentiary use of the "individual act" against the individual is not restricted to material actually produced but is instead broad enough to encompass the implications of production, Including its incompleteness. As Justice Kennedy has noted:

> An individual who produces documents may be asserting that [the documents] satisfy the general description in the subpoena, or that they were in his possession or under his control. [In either case, those] assertions can convey information about that individual's knowledge and state of mind as effectively as spoken statements. . . .

Id. at 122 (Kennedy, J. dissenting) (emphasis added); see *Fisher, 425 U.S. at 410; Curcio v. United States, 354 U.S. 118, 125, 1 L. Ed. 2d 1225, 77 S. Ct. 1145 (1957).* Thus, the testimonial aspect of production is not limited to the act of handing material over to the government — It also may include the custodian's exercise of discretion over which material to produce and which to omit. Incomplete production may therefore be as communicative as complete production.

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While "the act of producing documents in response to a subpoena . . . has communicative aspects of its own, wholly aside from the contents of the papers produced[,] . . . whether the tacit averments of the taxpayer are both 'testimonial' and 'incriminating' for purposes of applying the Fifth Amendment . . . depend on the facts and circumstances of particular cases. . . ." *Braswell, 487 U.S. at 103* (quoting *Fisher v. United States, 425 U.S. 391, 410, 48 L. Ed. 2d 39, 96 S. Ct. 1569 (1976)).* In this case, we find that the government's use at trial of evidence concerning Russell's nonproduction makes plain both its testimonial and its incriminating qualities. Cf. *Fisher, 425 U.S. at 410-11* (resolving the case on the appellate record even though the determination was factual). The government introduced evidence of nonproduction not only as an overt act in furtherance of the conspiracy to evade assessment, see Superseding Indictment at 8-9, but also as testimonial evidence of a guilty mind, see Superseding Indictment at 9; Trial Tr., Mar. 12, 1996, at 14243 (government's closing argument); Trial Tr., Mar. 1, 1996, at 82, 88 (direct testimony of investigating agent regarding receipt of corporate records and meeting with Russell); Trial Tr., Feb. 27, 1996, at 15 (government's opening statement).[3] The government's repeated reference to Russell's incomplete act of production as evidence of his culpability flies in the face of Braswell and vitiated Russell's Fifth Amendment privilege.[4]

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3. It thus bore not only on Count Two but also on Count Three ("willfully" making and subscribing a false return). *26 U.S.C. § 7206*(1).

4. The government would have us make an exception to the Fifth Amendment where the custodian's nonproduction is in furtherance of his alleged offense. While such exceptions to certain privileges do exist (e.g., crime or fraud exception to the attorney-client privilege, see *In re Sealed Case, 323 U.S. App. D.C. 233, 107 F.3d 46 (D.C. Cir. 1997)),*

(Cont'd)

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B. Waiver

The government contends that Russell waived the Fifth Amendment privilege when he failed to claim it at the time when he produced the subpoenaed documents. See *Rogers v. United States, 340 U.S 367,370,95 L. Ed. 344, 71 S. Ct. 438 (1951)* ("The privilege is deemed waived unless invoked."). The government's argument that the privilege may be waived by making a voluntary statement is not apposite to the issue before us, which concerns the evidentiary use of a response to a subpoena for the production of documents. While the Fifth Amendment is generally not self-executing, where a testimonial act is, as in this case, compelled, the defendant does not waive the privilege by failing to invoke it. See *Adams v. Maryland, 347 U.S. 1 79, 98 L. Ed. 608, 74 S. Ct. 442 (1954)* (holding the Fifth Amendment self-executing where testimony was compelled by a congressional grant of use immunity).

As with congressional testimony elicited pursuant to a summons that promises use immunity, see id., a subpoena to the corporate custodian for corporate records cannot be refused. The personal privilege against being identified as the individual who complied with the subpoena is a " 'necessary concomitantt' of the fact that a corporate, or government, custodian acts in a representative rather than a personal capacity." *United States v.*

(Cont'd)
the Fifth Amendment admits no such limitation (except in one narrow circumstance where the privilege against self-incrimination embedded in the Miranda warning is overcome by the public's interest in safety. see *New York v. Quarles, 467 U.S. 649, 657-60, 81 L. Ed. 2d 550, 104 S. Ct. 2626 (1984)).* Indeed, the government's exception would swallow the privilege in its entirety.

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Dean, 300 U.S. App. D.C. 333, 989 F.2d 1205, 1210 (D.C. Cir. 1993).[5]

C. Harmless Error Analysis

The district court's erroneous admission of evidence concerning Russell's production of documents mandates reversal of his conviction unless it was "harmless beyond a reasonable doubt." *Chapman v. California, 386 U.S. 18, 24,1 7 L. Ed. 2d 705, 87 S. Ct. 824 (1967).* The government bears the "burden of showing the absence of prejudice." *United States v. Olano, 507 U.S. 725, 734, 123 L. Ed. 2d 508,113 S. Ct. 1 770 (1993).* Although the government did not argue harmless error, we have discretion to consider it. *United States v. Giovannetti, 928 F.2d 225, 227 (7th Cir. 1991);* see *United States v. Rose, 104 F.3d 1408, 1414* (1st Cir.) (adopting discretionary standard for overlooking government failure to raise harmlessness), cert. denied, *138 L. Ed. 2d 187, 117 S. Ct. 2424, 1997 WL 251219 (1997); Horsley v. Alabama, 45 F.3d 1486, 1492 n.10 (11th Cir. 1995)* (same), cert. denied, *516 U.S. 960, 133 L. Ed. 2d 328, 116 S. Ct. 410 (1996); United States v. Langston, 970 F.2d 692, 704 n.9 (both Cir. 1992)* (same); *Lufkins v. Leapley, 965 F.2d 1477,1481 (8th Cir. 1992)* (same); *United States v.*

5. A statement voluntarily given to the government by a custodian may be admissible against him in a later criminal proceeding. See *United States v. Washington, 431 U.S. 181,186-87,52 L. Ed. 2d 238, 97 S. Ct. 1814 (1977).* The government alleges that statements made by Russell in conjunction with his handing over requested documents amounted to a voluntary statement and thereby waived all rights against self-incrimination described in Braswell. Review of the trial testimony belies the government's contention. The investigating officer conceded at trial that the meeting "was not an interview of Russell" and that Russell's only testimonial act was to produce a list of the documents that he had delivered.

Pryce, 291 U.S. App. D.C. 84,938 F.2d 1343,1348 (D.C. Cir. 1991) (same).

> In deciding whether to exercise that discretion, the controlling considerations are the length and complexity of the record, whether the harmlessness of the error or errors found is certain or debatable, and whether a reversal will result in protracted, costly, and ultimately futile proceedings in the district court.

Giovannetti, 928 F.2d at 227. Here the record is complex, and "the certainty of harmlessness does not appear with such clarity from an unguided search of the record that we should raise the issue on our own motion." Id. Although a reversal may be costly, we must vacate Russell's convictions.

II. ADEQUACY OF THE INDICTMENT

Mark McLaughlin complains that because the Indictment charged him with evasion of payment of taxes rather than with evasion of assessment of taxes, see *26 U.S. C. § 7201,* there was a failure of proof at trial. Because the McLaughlins did not raise this claim before the district court, plain error analysis applies. Fed. R. Crim. P. 52(b). Section 7201 states, in relevant part: "Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall . . . be guilty of a felony. . . ." *26 U.S.C. § 7201.* Count Two of the indictment charged that the McLaughlins

> willfully attempted to evade and defeat the payment of a large part of the income tax due and owing by [BIU] . . . by concealing and attempting to conceal

> from BIU's accountant and the Internal Revenue Service the nature and extent of BIU's income and the location thereof, and by making false statements to BIU's accountant with respect to the nature and extent of BIU's income.

Section 7201 includes two distinct offenses: evading assessment and evading payment. *Sansone v. United States, 380 U.S. 343, 354, 13 L. Ed. 2d 882, 85 S. Ct. 1004 (1965).* These offenses require different elements of proof, compare *United States v. McGill, 964 F.2d 222, 229 (3d Cir. 1992)* (listing elements of "evasion of payment") with *Cohen v. United States, 297 F.2d 760, 770 (9th Cir. 1962)* (listing various means to evade assessment), but "they frequently overlap." *United States v. Mal, 942 F.2d 682, 688 (9th Cir. 1991);* see *United States v. Dunkel, 900 F.2d 105, 107 (7th Cir. 1990)* (stating that although "sometimes it is convenient to say that different methods are different 'crimes' . . . nothing in the text or history of § 7201 requires an indictment to treat § 7201 as if it were two sections of the United States Code"), vacated on other grounds by *498 U.S. 1043 (1991).*

Had the government charged the McLaughlins with evasion of payment, it would have had to prove a valid assessment from which the McLaughlins hid assets. *United States v. England, 347 F.2d 425 43 (7th Cir. 1965).* The government did not prove that element. Thus, the conviction may stand only if the government's proof at trial did not amend the indictment and if the language of the indictment was sufficiently broad to put the McLaughlins on notice that the government would proceed under the evasion-of-assessment theory.

With respect to amendment of the indictment, two types of amendments are impermissible: "First, . . . any amendment that

transforms an indictment from one that does not state an offense into one that does . . . [and second,] any charge that tends to increase the defendant's burden at trial." *United States v. Milestone, 626 F.2d 264, 269 (3d Cir. 1980).* Despite its vagueness, the indictment clearly states an offense. And though the count may have been poorly articulated, it did not increase the McLaughlins' burden at trial. Thus, there was no impermissible amendment of the indictment.

We next consider whether there was a variance [between the indictment and the crime proved] [that] actually prejudice[d] the defendant." *United States v. Somers, 496 F.2d 723, 744 (3d Cir. 1974).* Variances "are examined on a case-by-case basis and constitute reversible error only if the defendant was prejudiced." *United States v. Smith, 789 F.2d 196, 200 (3d Cir. 1986).* In this case, no prejudice occurred: (1) a reading of the entire indictment makes clear that the government intended to proceed on a theory of evasion of assessment: (2) Mark's own attorney addressed the evasion-of-assessment theory at trial; and (3) Count Two itself specified conduct relevant only to an evasion-of-assessment theory (e.g., concealing income from BIU's own accountants). As in *United States v. Waldeck, 909 F.2d 555 (1st Cir. 1990),* "it was clear at the start of trial that the government was proceeding on an evasion-of-assessment theory." *Id. at 558.*

III. FAILURE TO ISSUE SUMMONSES AND GIVE NOTICE UNDER 26 *U.S.C. §§ 7602*(A)(2), 7609(A)

The IRS Interviewed BIU's former accountant and received records from him without first issuing a summons, see *26 U.S.C. § 7602*(a), and giving the McLaughlins concomitant notice of its request for records. See *26 U.S.C. § 7609*(a). The

McLaughlins' motion to suppress the evidence so obtained was denied by the district court. Mark McLaughlin contends that the IRS's failure to issue the summons and give notice violated 26 *U.S.C.* § 7609(a). Our review is plenary. *United States v. Emanuele, 51 F.3d 1123, 1127 (3d Cir. 1995).*

If the IRS had issued a summons to a third-party recordkeeper and the summons had "required the production of any portion of records made or kept of the business transactions or affairs of" BIU, the McLaughlins would have been entitled to receive notice of the summons. *26 U.S.C. § 7609*(a)(1). In this case, the IRS issued no summons and therefore gave no notice of the informal interview and voluntary document delivery. See id. (stating that notice is required "if . . . any summons (emphasis added)) . . . is served. . . ."

The IRS has broad discretion on how it conducts its investigations. See *26 U.S.C. § 7602*. As the Ninth Circuit has said:

> Section 7602 provides three separate means of . . . inquiry. Section 7602(a)(1) provides for an informal, noncompulsory means of inquiry. If an informal inquiry proves inadequate, Sections 7602(a)(2) and 7602(a)(3) provide mechanisms for the formal compulsion of the production of documents and testimony.

Speck v. United States, 59 F.3d 106, 108 (9th Cir. 1995). "Nothing . . . in the text of Section 7602 suggests that subsection (a)(2) should be read to exclude informal or noncoercive attempts to obtain information about possible failures to report income." Id. Section 7602(a) permits the

government to conduct a formal investigation and issue summonses or to proceed informally. In this case, the government chose to proceed informally, and BIU's former accountant cooperated with the investigation. It was entitled to do so without notifying Mark.

IV. ADMONITION TO DEFENSE COUNSEL IN PRESENCE OF JURY

During the defense's recross of BIU's accountant, who appeared under government subpoena, the court interrupted and questioned the propriety of defense counsel's asking leading questions of the witness whom the McLaughlins were compensating for his time at trial. Defense counsel argued that the witness had been subpoenaed by the government and that his compensation was irrelevant. The judge later conceded that he had been rough with defense counsel and gave a curative Instruction to the jury, in which he praised the integrity of counsel.[6] Mark now seeks a new trial on the ground that the district court's intervention in the questioning was reversible error.

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6. The court gave the following curative instruction to the jury:

> Some matters took place this morning and I perhaps got a little grumpy with counsel. I want to tell you that you in no way should draw any adverse inference against the lawyers or against the defendants in this case. I can attest that these lawyers are all swell guys. I like them personally, and they are ethical as the day is long. And you should not draw any adverse inference whatsoever. They are fine fellows and they are doing their jobs and they are doing it very ably. A little matter came up and you shouldn't concern yourselves with that at all.

Though the court's comments reflected unfavorably on defense counsel, the court did not "lose[] its color of neutrality [or] tend[] to accentuate and emphasize the prosecution's case." *United States v. Bland, 697 F.2d 262, 265 (8th Cir. 1983).* The court's comments neither undermined the McLaughlins' defense nor buttressed the government's case. They at most implied frustration with the form of counsel's questions and some discomfort with the witness' relationship with defendants. The inferences that a jury could have drawn from the court's comments are not of such a serious nature as to constitute reversible error, particularly in view of the court's [curative instruction]." *Sleek v. J.C. Penney Co., 324 F.2d 467, 477 (3d Cir. 1963);* see *United States v. Price, 13 F.3d 711, 723 (3d Cir. 1994); United States v. Stayback, 212 F.2d 313, 319 (3d Cir. 1954).*

V. SENTENCING GUIDELINE ISSUES[7]

Mark McLaughlin was sentenced on the basis of an adjusted offense level of 17. The Pre-Sentence Report ("PSR"), which the court adopted, assigned Mark a base offense level of 15, see U.S. Sentencing Guidelines Manual § 2T1.1 (1988) ("U.S.S.G."), and recommended a two-point upward adjustment for obstruction of justice. See U.S.S.G. § 3C1.1. Mark appeals the sentence on three grounds: (1) the tax loss upon which he was sentenced was artificially inflated by including income on which taxes were already being paid; (2) the Sentencing Commission exceeded its authority by including interest in the computation of tax loss; and (3) the upward adjustment for obstruction of justice was not warranted. The district court rejected these arguments.

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7. All parties agree that the 1988 Sentencing Guidelines apply.

Appendix D

A. Determination of loss Amount for Sentencing Purposes

Mark McLaughlin contended at both trial and sentencing and argues again here that taxes were being paid on the income in the First Fidelity account and therefore that no tax loss was attributable to the income deposited in that account. The district court rejected the argument and at sentencing took into account all funds deposited in both the NJNB and First Fidelity bank accounts, which amounted to roughly $1,400,000 in income.

In his brief, Mark recites trial evidence bearing on the issue of whether the First Fidelity account was a reserve against future claims and argues that the jury may have rendered a verdict based solely on the nonreporting of the NJNB account. The jury returned a general verdict of guilty that does not distinguish between the accounts. Cf. *United States v. Bailin 977 F.2d 27(), 282 (3d Cir. 1992)* ("When a case involves a general verdict, establishing that the verdict necessarily determined any particular issue is extremely difficult.").

Where the jury does not determine the amount of tax evaded, the determination must be made by the trial judge. *United States v. Olbres, 99 F.3d 28, 31 (1st Cir. 1996).* The district court received extensive briefing on the question of loss, conducted a hearing, and made a finding that:

With respect to the accountability for the $ 770,000 [in the First Fidelity account], in my view, viewing the record as a whole, it clearly makes these defendants accountable for both of the accounts in the criminal context.[8]

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8. The McLaughlins did not challenge the inclusion of the NJNB account in the calculation.

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We review the district court's determination of the amount of loss for clear error. *United States v. Colletti, 984 F.2d 1339,1345 (3d Cir. 1992).*

Mark contends that the First Fidelity account was a reserve against future warranty claims and that its balance therefore was being treated as accrued income over ten years. He claims that BIU or another McLaughlin-related affiliate has treated a prorated portion of the account as income on every return since 1988, before BIU was aware of the government investigation. The government argues in response that the McLaughlins' fraudulent activities extended to both accounts and that, even if the jury's verdict rested on only one account, the court could have considered fraudulent conduct with respect to the other as relevant conduct. See U.S.S.G. § 1B1.3(a). The government moreover points to evidence indicating that funds in the First Fidelity account were used to capitalize other ventures.

The record is complex and the facts were hotly disputed. On the record before us, we cannot say that the district court's finding was clearly erroneous.[9]

B. Including Interest in Loss Amount

Mark contends that the Sentencing Commission exceeded its statutory authority when it included interest on unpaid taxes in the computation of tax loss. See U.S.S.G. § 2T1.1 app. n.2. The provision in the Code that describes the authority of the Commission states that the Guidelines should "provide certainty

9. Mark also contests the Inclusion of four smaller amounts totaling roughly $ 200,000 in the computation of tax loss. That argument was rejected by the district court in its disposition of this matter. The court's findings were not clearly erroneous.

and fairness in sentencing and reduce unwarranted sentence disparities." *18 U.S.C. 994*(f). Mark argues that including accumulated interest in the calculation of tax loss exacerbates sentencing disparities by causing defendants' sentences to depend largely on when the government brings its case (and therefore how much interest accumulates) rather than on the amount of income hidden from assessment.

Including interest in computing tax loss to the government merely recognizes the time value of money. Far from being beyond the Commission's authority, it is a rational calculation of the real loss sustained as a consequence of a taxpayer's illegally concealing his income from assessment. Whatever capacity the government has to affect the magnitude of a defendant's sentence by choosing strategically when to indict an allegedly wayward taxpayer, no allegation of any impropriety is made here. Furthermore, it is always within the taxpayer's power to pay the deficiency and to stop interest from accruing. In short, "we fail to see how the general statutory provision, outlining the purpose of the guidelines, supports [Mark's] contention." *United States v. Sanchez, 995 F.2d* 468,470 (3d *Cir.* 1993).

C. Two-level Enhancement for Obstruction of Justice

In imposing a two-level enhancement for obstruction of justice on the McLaughlins, the district court found:

Finally, with respect to obstruction of justice, in addition to what was related to me as the taping and garnering of alleged evidence or effort so to do in preparation for the [pretrial] hearing . . . It seems to me that was going mighty far stretching the envelope of advocacy, frankly, in an effort to come up with some evidence to try to derail this prosecution.

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But looking at what the Government has said on pages 11 and 12 of its brief, which are clearly made out by the record and I find them to have factual basis, in my view, that does constitute going that extra step, which is required in the United States versus Dunnigan . . . demonstrating a willful impediment, seeking to establish a willful impediment to obstruction of justice, or an attempt to do the same perjuriously.

For example, when Mark McLaughlin testified . . . that, in order to add additional money to "the reserve, "we formed a bank account in South Jersey into which we deposited cash into that account." The defense concedes that the jury convicted the Defendants of failing to report this income. . . .

We review the sufficiency of the district court's findings supporting the imposition of a sentence enhancement for clear error. See U.S. v. *Maurello, 76 F.3d 1304,1308 (3d Cir.* 1996) ("If a decision is 'essentially factual,' we apply a clearly erroneous standard.").

Section 3C1.1 of the Sentencing Guidelines authorizes a two level increase in the offense level "if the defendant willfully obstructed or impeded . . . the administration of justice during the investigation, prosecution or sentencing of the instant offense. . . ." U.S.S.G. § 3C1.1. Application Note 3(a) lists as an example of conduct to which the enhancement applies "threatening, intimidating, or otherwise unlawfully influencing a . . . witness . . . directly or indirectly, or attempting to do so." U.S.S.G. § 3CI.1 app. n.3(a).

The conduct to which the court referred in the first part of its findings, as described in the government's brief, consisted

of the McLaughlins' sending investigators to obtain tape-recorded statements from witnesses in an effort to demonstrate that the investigating IRS agent had violated the McLaughlins' constitutional rights. The investigators evidently did not disclose their identities and made secret recordings of their interviews. While the secret tape-recording of statements by persons who concealed their identity may be prohibited under the laws of some states (as the district court observed), it does not amount to conduct encompassed by the Application Note. There is no contention, nor any evidence, that the McLaughlins "threatened, intimidated or otherwise unlawfully influenced" any witness or attempted to do so." See id.

The court's second ground for imposing the enhancement was that the McLaughlins gave perjured testimony. Application Note 3 includes perjury as one of the types of conduct for which the enhancement may be imposed. In *United States v. Dunnigan, 507 U.S. 87, 122 L. Ed. 2d 445,113 S. Ct. 1111 (1993),* the Court held that a finding of perjury for purposes of the guideline enhancement requires proof that false testimony was given "with the willful intent to provide false testimony, rather than as a result of confusion, mistake or faulty memory." *Id. at* 94. The Court added:

> [A] district court must review the evidence and make independent findings necessary to establish a willful impediment to or obstruction of justice . . . under the perjury definition . . . set out [above].

Id. at 95. Here the district court based its finding principally on Mark's testimony that the First Fidelity account was a "reserve," i.e., one with respect to which he claimed income was accrued

and taxes paid when earned.[10] Application Note 1 directs that the "alleged false testimony . . . by the defendant . . . be evaluated in a light most favorable to the defendant." U.S.S.G. § 3C1.1 app. n.1. Relying on that note, we have held that this note requires that the sentencing court refrain from imposing a § 3C1.1 enhancement for giving perjurious testimony unless the government satisfies its burden of "clearly convincing the court that it is more likely than not that the defendant has been untruthful." *United States v. Arnold, 106 F.3d 37, 44 (3d Cir. 1997).* Here, the court failed to hold the government to its burden of proof.

Even assuming that Mark's conviction for "willful evasion of tax" implies that the jury rejected all of Mark's explanations for the failure to declare either account's balance as income,[11] that alone would not be sufficient to support a finding that Mark testified "with the willful intent to provide false testimony." As we held in *United States v. Colletti, 984 F.2d 1339 (3d Cir. 1992)*:

> In order to warrant the two point enhancement for obstruction of justice, the perjury of the defendant must not only be clearly established, and supported

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10. The government in its brief referred to in the court's finding also mentions a statement made by the McLaughlins to the agent during the investigation claiming the account to be a reserve, testimony by Russell that he had told the agent an account was a warranty account, and testimony by him that he did not know BIU's 1988 return omitted substantial amounts of BIU income.

11. As we noted earlier, see supra p. the jury's general verdict does not disclose whether the jury rejected all or only part of Mark's testimony.

> by evidence other than the jury's having disbelieved him, but also must be sufficiently far-reaching as to impose some incremental burdens upon the government, either in investigation or proof, which would not have been necessary but for the perjury.

984 F.2d at 1384 (emphasis added).

Accordingly, we conclude that imposition of the section 3C1.1 enhancement was clear error. We vacate Mark McLaughlin's sentence.

V. CONCLUSION

We VACATE Russell McLaughlin, Jr.'s convictions and REMAND for a new trial. We VACATE Mark McLaughlin's sentence and REMAND for resentencing consistent with this opinion.

CONCUR BY: BECKER

CONCUR:
BECKER, Circuit Judge, concurring.

This is a close and difficult case, with many complications. I believe that the result that Judge Schwarzer reaches is correct, but I write separately because I come to that result by a more tortuous route, which I feel compelled to explain. That explanation will also identify the many concerns I have about the law in this area, which I hope can be dealt with in future cases. These concerns arise, I hasten to add, not because of any deficiency in Judge Schwarzer's opinion but because of the tensions created by *Braswell v. United States, 487 U.S. 99, 101 L. Ed. 2d 98, 108 S. Ct. 2284 (1988)* and the application of Braswell to cases that go beyond Braswell's facts.

Appendix D

I.

The Supreme Court held in Braswell that a corporate records custodian may not invoke his Fifth Amendment privilege against self-incrimination to resist a government summons or subpoena for corporate records even if the act of producing such records would relate information that would incriminate him. However, because the act of production is a corporate act, i.e., the custodian produces the documents as an agent for the corporation, the Court also held that the government may not use that act against the custodian in a prosecution against him personally.

In part I.A. of his opinion, Judge Schwarzer implicitly assumes that all acts of non-production related to a summons or subpoena are corporate acts, and that the government therefore cannot introduce evidence of this non-production against the custodian. I believe this to be an uncritical assumption. Whether an act of nonproduction is a corporate act turns on principles of agency law. A good faith decision by a records custodian to withhold documents he believes to be irrelevant to a summons or a subpoena is a corporate act. But, what if the custodian fails to turn over documents sought by the government because of gross negligence, deliberate indifference, or recklessness? Or, what if the custodian willfully and unlawfully chooses not to comply (as may well have happened here)? Are these acts of non-production within the custodian's agency? Hornbook agency law answers these questions with a "maybe." See Restatement (Second) of Agency § 34 cmg. g (1957) ("Authority to do Illegal or tortious acts, whether or not criminal, is not readily inferred.").[1] In short, It is not clear to me that a records

1. A further potential complication is determining whether state or federal common law applies to define the scope of the agency, and, if state law applies (which I suspect it does), determining which state law to apply.

custodian will always be acting in his representative capacity when he fails to respond to a summons or a subpoena.

In this case, at least as I understand the record, there were no findings in the district court with respect to whether Russell McLaughlin, Jr. acted within his agency when he failed to comply adequately with the relevant IRS summons. I suppose, however, that such agency could be inferred. Building Inspections Underwriters, Inc. ("BIU") and its closely related businesses were owned and operated by the McLaughlin family, three of whom were indicted for tax evasion. It would not be unreasonable to conclude that the corporation as an entity directed its agent Russell McLaughlin, Jr., the President of the company, to withhold certain documents. However, It would seem inappropriate for us to draw that inference on this record without further Investigation into the governing structure of the interlocking companies. In other words, under straightforward application of principles of hornbook agency law, we cannot now say for certain that McLaughlin acted within his agency. To conclude that McLaughlin acted within his agency (as I ultimately do), we must therefore look beyond hornbook agency law.

If McLaughlin acted outside his agency, then the Braswell protections likely do no apply. See *Braswell 487 U.S. at 118 n. 11* ("The limitation [against introducing the act of production against a custodian personally] is a necessary concomitant of the notion that a corporate custodian acts as an agent and not an individual when he produces corporate records in response to a subpoena addressed to him in his representative capacity."). Still, the government may be prohibited from introducing his act of non-production at a prosecution against him. For, if McLaughlin acted in his personal capacity and does not enjoy the protections afforded by Braswell, he may nevertheless enjoy

a Fifth Amendment privilege against the compelled, incriminating testimony effected by the summons, if the elements of a privilege claim are met.

The elements of compulsion were arguably present here, for the summons or subpoena itself compelled McLaughlin not only to turn over records, but also to exercise his discretion as to whether certain documents fall within the scope of the summons or subpoena. Subject to the reservations set forth in the margin, I reason that he was therefore compelled to make a choice.[2]

Whether an act is testimonial and incriminating depends on the facts of a given case. See *Fisher v. United States, 425*

2. It is not entirely clear that a records custodian who inadequately complies with a summons or subpoena has been compelled, and, of course, if there is no compulsion, then the act of non-production could be introduced against the custodian (assuming that act was outside the scope of his agency). There are at least two ways of describing the factual scenario in such a way as to conclude that there is no compulsion (neither of which is wholly satisfying). First, it could be said that any compulsion is directed at the corporation or at least at an individual in his representative capacity, not the individual in his personal capacity. Although I am unaware of any discussion on this precise point, the Supreme court, in cases such as Braswell, has focused on the testimonial aspects of a records custodian's producing records. It seems to have assumed that personal compulsion is present: otherwise, it would not have needed to create evidentiary limitations on introducing the act of production because there would be no concerns at all about violating the individual's Filth Amendment privileges. Second, it could be said that the government did not compel the act of non-production, but only the act of production; at least in the case of the custodian who acted willfully, he may be said to have voluntarily chosen to disregard the summons or subpoena. Yet that voluntary act of non-compliance occurred only after the government compelled the custodian to engage in the decisional process in the first place. See infra.

U.S. 391, 410, 48 L. Ed. 2d 39, 96 S. Ct. 1569 (1976). There are a number of potential testimonial aspects of an act of production. Those aspects include the following: that the records produced existed; that the custodian had possession and control over the records; that the custodian believed the records to be subject to the subpoena or summons; and that the records are authentic. An act of non-production similarly has numerous testimonial aspects, including the following: that the documents requested do not exist; that the custodian did not possess or control the documents; that the custodian did not believe the documents to be subject to the subpoena or summons; and that the custodian believed that the withheld documents were relevant and that their contents or the act of producing them were incriminating.

In this case, the very act of non-production — the result of the compelled choice — related certain information. See *Doe v. United States, 487 US. 201, 21], 101 L Ed. 2d 184, 108 S. Ct. 2341 (1988).* That McLaughlin failed to comply fully with the summons arguably implied that he believed that the withheld documents were relevant and that their contents or the act of producing them were incriminating. That failure may have further implied that McLaughlin had earlier willfully failed to report the contents of the documents (income from BIU) to the IRS. The government used these implications against McLaughlin at trial, arguing that the non-production of the documents evidenced McLaughlin's intent to evade federal taxes. The act of non-production, then, appears to have been incriminating. Thus, in this case, even if McLaughlin were not acting within his agency, I believe that the government could not use his act of nonproduction against him because to do so would have violated his Fifth Amendment rights. But, if we so hold, would we be undermining Braswell by permitting a nonproducing custodian to claim his Fifth Amendment rights?

Appendix D

II.

It is at this point that the complexities and problems of the case begin to crystallize. Going forward, how are we to apply this case and Braswell to future Russell McLaughlins? Assume that a grand jury issues a subpoena to a records custodian (as happened in Braswell). He refuses to comply, and seeks to quash the subpoena, invoking his Fifth Amendment privileges. The government opposes the motion to quash. What is the court to do? As a first step, the court should determine whether Braswell applies and prohibits the custodian from invoking his personal Fifth Amendment rights. But that would require the court to determine whether the custodian planned to act outside the scope of his agency in responding to the subpoena. Such a question could effectively require the custodian to imply that he intends to act unlawfully by withholding relevant documents. As a condition of claiming his privilege against self-incrimination, then, the custodian would need to incriminate himself. Perhaps the court could prohibit the government from using that admission against the custodian at some future prosecution, but this prohibition further complicates an already complicated problem.

Even undertaking an analysis as to whether Braswell applies may undermine it. By undertaking such an analysis, the court might signal to the custodian that there is a way around Braswell, and a way around complying with the subpoena. If the custodian knows that compliance with the subpoena would force him to turn over documents the contents of which are personally incriminating or the act of production of which is personally incriminating, then he may claim that he plans to act outside his agency when he responds to the subpoena (and risk that his admission might lead to or support some future prosecution).

In that case, a devious custodian can invoke his Fifth Amendment privilege and resist the subpoena, the very outcome Braswell sought to avoid.

As suggested above, the court might attempt to limit the use of the results of complying with the subpoena, i.e., the act of production or non-production, to ensure that any testimonial aspects of being compelled to respond to the subpoena are not used to incriminate. Under *United States v. Doe, 465 U.S. 605, 616-17, 79 L. Ed. 2d 552, 104 S. Ct. 1237 (1984),* the court cannot by itself prospectively limit the use of testimonial acts that have been compelled. The court can, however, suggest that if the government wants to compel a response to the subpoena that might be testimonial it must do so by resort to a statutory grant of use immunity pursuant to *18 U.S.C. §§ 6002* and 6003. But, such a suggestion violates at least the spirit of Braswell The Court in Braswell strove mightily to ensure that the government could compel a records custodian to comply with a subpoena without first providing him statutory use immunity, an immunity that could stymie any prosecution directed at him.[3]

The only way to avoid this morass altogether, at least as I see it, is to assume in all cases (as Judge Schwarzer seems to do) that a records custodian will always act within his agency when he responds to a government subpoena or summons. Working from that assumption, this case and our hypothetical

3. The court might also choose to appoint an alternate custodian (for example, outside legal counsel) to respond to the subpoena. Braswell strongly discourages this course. How, the Supreme Court asks, is an alternate custodian, unfamiliar with the record-keeping machinery of the entity, to respond adequately to a subpoena? The Court assumes, correctly I believe, that resort to an alternate custodian all but ensures that the entity will not turn over the documents the government seeks.

case are easy; under Braswell, neither McLaughlin nor our hypothetical records custodian can invoke his personal Fifth Amendment rights to resist a summons or a subpoena served on the entity he represents, but the government cannot use any act of production or non-production in a prosecution against him. However, as I noted above, I believe that such an assumption stretches hornbook agency law. I am willing to accept such a stretch because the alternative is to undermine either Braswell or Fifth Amendment jurisprudence more generally. However, I think that the problems that I have identified need exploration in future cases.

Whichever way the pie is sliced here, I believe that the use of McLaughlin's act of non-production against him personally would be unlawful. I therefore join Judge Schwarzer's opinion.

APPENDIX E — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA FILED SEPTEMBER 3, 1996

UNITED STATES OF AMERICA v. RUSSELL McLAUGHLIN, JR., MARK McLAUGHLIN

CRIMINAL NO. 95- 113

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

1996 U.S. Dist. LEXIS 12983

August 30, 1996, Decided

September 3, 1996, FILED; September 4, 1996, ENTERED

DISPOSITION: Post-trial motions DENIED.

* * *

JUDGES: Robert S. Gawthrop, III, JUDGE

OPINION BY: Robert S. Gawthrop, III

OPINION: OPINION

Gawthrop, J.

30 August 1996

Following their conviction for tax evasion, *26 U.S.C. § 7201*, and Russell McLaughlin, Jr.'s conviction for subscribing a false tax return, *26 U.S.C. § 7206(1)*, the defendants move

for judgment of acquittal or, in the alternative, for a new trial. The defendants raise a number of arguments in their post-trial motions that have already been decided, in the court's view accurately, with the reasons therefor appearing upon the record. I shall thus confine this opinion to but two issues that deserve additional treatment: (1) the government's introduction of evidence of Russell McLaughlin's individual act of producing documents to IRS Special Agent Robert White; and (2) the defense payment of a government witness together with the colloquy before the jury that that scenario engendered. Upon the following reasoning, I shall deny the motions.

At trial, the government introduced evidence of Russell McLaughlin's individual act of production of certain documents without drawing a defense objection. Agent White testified on direct examination:

> Q: I want to show you [what has been] previously marked Government's 9A for identification. Do you recognize that, Agent White?
>
> A: Yes, I do.
>
> Q: What is it?
>
> A: Government Exhibit 9A is a summons, and there is an attachment to it.
>
> Q: And who prepared that summons?
>
> A: I did.
>
> . . . .

Appendix E

Ms. Barden: Your Honor, we offer 9A for identification into evidence.

Mr. Schwartzman: No objection.

Mr. Fisher: No objection.

The Court: Admitted.

Q: To whom was the summons directed?

A: Russ McLaughlin, Junior.

Q: And was there a reason that it was directed to him?

A: Yes, he was the president of the company.

. . . .

Q: Agent White, on October 20th of 1989, did you talk with Russell McLaughlin, Junior?

A: Yes, I did.

Q: And what was the purpose of your conversation with him?

A: Relative to the summons, I was talking to him as a custodian and officer of BIU to find out what records was [sic] being presented to me.

Appendix E

Trial Day Five, 62-65

The defendants argue that, under *Braswell v. United States, 487 U.S. 99, IOI L. Ed. 2d 98, 108 S. Ct. 2284 (1988),* the government's introduction of this evidence of Russell McLaughlin's individual act of producing documents to Agent White constitutes reversible error. The government counters that Russell McLaughlin failed to assert his Fifth Amendment privilege when Agent White questioned him and thus waived any Braswell objection he may have had. In Braswell, the Supreme Court held that, because a custodian of corporate records acts as an agent for the corporation, he has no Fifth Amendment privilege to resist a summons for such records, even if those records could incriminate him. While the government may use the corporation's records and place them into evidence, it may not use the individual act of production of those records against the custodian:

> In a criminal prosecution against the custodian, the Government may not introduce into evidence before the jury the fact that the subpoena was served upon and the corporation's documents were delivered by one particular individual, the custodian.

487 US. at 118. Thus Braswell is on point.

However, because the Braswell prohibition is grounded in the Fifth Amendment, in order for the defendant Russell McLaughlin to have the benefit of its protection, he was required to invoke that amendment, he was required to object. A defendant must assert he constitutional privilege against self-incrimination; otherwise it is waived. *United States v. Kordel, 397 US. 1, 25 L. Ed. 2d 1, 90 S. Ct. 763 (1970); Rogers v. United States, 340 US. 367, 95 L. Ed. 344, 71 S. Ct. 438 (1951).*

The question turns to when he must object. The government argues that a records custodian must assert, at the time of the production of the documents pursuant to the IRS summons, his Fifth Amendment privilege, in order to protect his rights under Braswell not to have the fact of the act of production of those documents presented to the jury. I am not prepared to say that the doctrine of waiver goes that far. For there to be a waiver, there must be a voluntary, informed relinquishment of these rights. *Connecticut v. Barrett, 479 US. 523, 93 L. Ed. 2d 920, 107 S. Ct. 828 (1987); Miranda v. Arizona, 384 US. 436, 16 L. Ed. 2d 694, 86 S. Ct. 1602 (1966).* Since the act of production was not done while the custodian and future defendant was in custody, the protection of Miranda, which, of course, only applies to custodial interrogations, does not obtain. But I see a certain distinction between Miranda, which involves defendants' statements, outright confessions, and Braswell, which involves, in truth, a somewhat arcane exception to an exception to Miranda — to the Fifth Amendment. It is not the kind of subtle constitutional nuance that makes it into your basic 9th-grade civics class. To hold a putative, lay defendant accountable then to announce his Braswellian objection to the IRS agent, under penalty of waiver is, in my view, to ask too much. There is no indication on this record that Russell McLaughlin, Jr., knew what he was allegedly giving up, what he was waiving in that regard. I cannot find it than to have been a knowing, intelligent waiver.

There are two other stages at which the objection could be made: pretrial, and trial. A pretrial objection was here made, via the procedural vehicle of a motion to suppress, litigated before the Honorable J. William Ditter, Jr, of this court. Judge Ditter adjudicated the Miranda issue, but left the Braswell issue undecided. In this circuit, if a district court makes a definitive

pretrial ruling, with no suggestion that it would reconsider the matter at trial, counsel are not required to make a contemporaneous objection at trial in order to reserve the opportunity to assert reversible error on appeal. *Gov't of Virgin Islands v. Joseph, 27 VI. 389, 964 F:2d 1380, 1384-85 (3d Cir. 1992); United States v. Pearce, 792 F:2d 397, 400n.4 (3d Cir. 1986).* Conversely, one inexorably infers that if there is not such a definitive pretrial ruling, then one is required to object again at trial.

Here, there was neither a definitive pretrial ruling nor a contemporaneous objection made at trial. The very doctrine of Braswell was never even mentioned to this judge, the trial judge, until long after the evidence was in, the verdict recorded, and the jury sent home. That constitutes a waiver, and thus counsel's posttrial effort to rely upon Braswell is untimely and cannot now be heard.

At trial, a matter arose which has prompted another prong of this post-trial motion. Testifying as a witness on behalf of the government, under government subpoena, one William St. Clair spent two days on the witness stand. Right towards the end of his direct examination, it came to the attention of the court and jury that the defendants had been paying this government witness $ 165.00 per hour for all the time he had been expending on this case, testifying on the government's behalf, under government subpoena while on the witness stand. On cross-examination defense counsel began to ask Mr. St. Clair leading questions. The court intervened and the following colloquy ensued:

> The Court: Sir, I question the propriety of your asking leading questions of a witness that your

people have paid to come in here. He is a friendly witness to you. She [AUSA Maureen Barden] should be the one that should be allowed to cross-examine and not you, I think.

Mr. Fisher: Subpoenaed by the government; not by us.

The Court: And paid by you.

By Mr. Fisher:

Q: Were you paid for your testimony, or are you being paid for your time, sir?

A: I am being paid for my time.

The Court: As a fact witness; not an expert witness, correct?

The Witness: That is correct.

By Mr. Fisher: Now, is that customary for you to [be paid] for your time for other clients when you are called to testify in a case?

A: Yes, it is.

By The Court: You testify in other criminal cases, do you, for the government?

A: For criminal cases? No, Your Honor.

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> Q: He [Mr. Fisher] said customary, I'm talking about criminal case. Is it customary for you to get paid by the defendant when you are testifying under government subpoena in criminal cases?
>
> A: I have never been involved with one before.

Trial Day Five, 50-51.

Mr. St. Clair had been and still is, apparently, the defendants' accountant. They paid him the $ 165,00. hourly rate when he was performing services on their behalf, but it struck the court as most unusual for defendants in a criminal case to be paying hundreds and indeed, ultimately, thousand of dollars to a government witness for what witness's testimony while on the stand. That is not to say, of course, that in any way the witness would have nudged even slightly his testimony to favor that of his criminal-defendant, financial benefactors; nor is that to say that he would not have, either. It did have the tendency to dislodge the perception of testimonial disinterest.

The defendants question the propriety of the court's having questioned the propriety of defense counsel's asking leading questions of Mr. St. Clair. They argue that "there is nothing in the Federal Rules of Evidence which prohibits a criminal defendant from cross-examining any witness the government chooses to call, whether ostensibly 'friendly' or 'unfriendly,' even with leading questions." Def. Brief at 4. Actually, the rule reads, pertinently: "Ordinarily leading questions should be permitted on cross-examination." Fed. R. Evid. 611(c) (emphasis added). The commentators expound upon the provision, noting that, although leading questions on cross-examination can usually be asked as a matter of right, that right

is not absolute. "Where the witness is biased in favor of the cross examiner, the same danger of leading questions arises as on direct, and the court may, in its discretion, prohibit their use." Weinstein & Berger, Evidence, 611-84 (1988). See, e.g., *United States v. Hansen, 583 F:2d 325* (7th Cir.) (no abuse of discretion where defendant father not permitted to cross-examine co-defendant son who consistently tried to exonerate him), cert. den'd, *439 U.S. 91* (1978). It was thus not error to have suggested the curtailment of counsel's leading questions to their paid witness, albeit a paid-by-them witness appearing under the government's subpoena.

After this little to-and-fro over the propriety of defense counsel's asking leading questions of Mr. St. Clair, the discussion underwent a brief crescendo in its spiritedness, outside of the presence of the jury. Counsel now aver that the court should have granted their motion for a mistrial on the basis that its comments were unduly harsh, not only in substance, but in timbre and inflection. I denied the motion at the time, and I continue to believe that the little verbal flurry did not fatally infect the requisite quality of fairness of this trial by jury. Many a hard-fought trial will suffer an occasional seismic blip. Few jurisprudential jousts, in fact, are utterly placid ponds, unflecked with an occasional whitecap. This trial — fair, hard-fought, and ably fought — had its moments, when the seemingly incessant onslaught of technical tax and accounting minutiae would be punctuated by an occasional firework. Such is to be expected in a real courtroom.

Even though most of this took place outside the presence of the jury, the court, out of an abundance of caution, went the second mile in seeking to rid the jurors of any prejudice:

Appendix E

> Ladies and Gentlemen, some matters took place this morning and I perhaps got a little grumpy with counsel. I want to tell you that you in no way should draw any adverse inference against the lawyers or against the defendants in this case. I can attest that these lawyers are all swell guys, I like them personally, and they are ethical as the day is long.
>
> And you should not draw any adverse inference whatsoever. They are fine fellows and they are doing their jobs and they are doing it very ably. A little matter came up and you shouldn't concern yourselves with that at all.

Trial Day Five, 268.

The court clearly and rather glowingly told the jury not to be distracted by this little skirmish. If the discussion did occasion any unfair prejudice at all, I am certain that it was cured. It certainly provides no proper basis for a new trial.

An order follows.

ORDER

AND NOW, this 30th day of August, 1996, after consideration of the able briefs and oral arguments of counsel, it is hereby ordered that the post-trial motions of Russell and Mark McLaughlin are DENIED.

BY THE COURT:
Robert S. Gawthrop, III

APPENDIX F — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA, CRIMINAL NO. 95-00113, FILED DECEMBER 22, 1995

UNITED STATES OF AMERICA v. RUSSELL McLAUGHLIN JR., MARK McLAUGHLIN, and ROBIN McLAUGHLIN, a/k/a "Alice McLaughlin Pavlo"

CRIMINAL NO. 95-00113

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

December 22, 1995, Filed

* * *

JUDGES: JUDGE J. WILLIAM DITTER, JR.

OPINION BY: J. WILLIAM DITTER, JR.

OPINION: MEMORANDUM

DITTER, J.

The defendants, who are siblings, are under indictment for conspiracy, tax evasion, and filing a false federal income tax return in connection with the 1988 return of Building Inspection Underwriters, Inc. ("BIU"), a company they and members of their family own. BIU performs building inspections for municipalities in Pennsylvania and New Jersey. The defendants filed several pretrial motions seeking dismissal of the indictment, suppression of evidence, and the striking of certain allegations from the indictment.

Appendix F

I. The Motion to Dismiss the Indictment Based on Government Misconduct.

The defendants argue that "government misconduct" occurring during the investigation requires that I dismiss the charges against them. I should do so, they contend, either because the alleged misconduct violated the Constitution or pursuant to the federal courts' supervisory power. Dismissal of an indictment with prejudice is the "most severe sanction possible." *United States v. Isgro, 974 F:2d 1091, 1097 (9th Cir. 1992)*, cert. denied, *507 U.S. 985, 123 L. Ed. 2d 148, 113 S. Ct. 1581 (1993)*. Among other things, it means that possibly guilty defendants will go unpunished. Therefore, it is appropriate only in narrow circumstances where the government engaged in serious misconduct and such misconduct prejudiced the defendants. See *Bank of Nova Scotia v. United States, 487 U.S. 250, 254-55, 101 L. Ed. 2d 228, 108 S. Ct. 2369 (1988)*.

The defendants contend that Robert W. White, an Internal Revenue Service ("IRS") special agent, engaged in misconduct when he violated several agency regulations and federal statutes during the investigation. In support of their motion, the defendants subpoenaed Special Agent White and IRS Agents Robert Tengood and William Fredericks. Before compelling that testimony, I required the defendants to produce some evidence that Special Agent White actually engaged in misconduct that prejudiced the defendants. I held six days of hearings during which 16 witnesses testified. Because I find no violation of the defendants' constitutional or statutory rights and that exercise of my supervisory power is unwarranted, I will deny their motion to dismiss the indictment and refuse the defendants' request to compel the IRS agents' testimony.

Appendix F

A. The Alleged Misconduct.

1. Violations of IRS policies and regulations.

The defendants allege that the following acts and omissions by Special Agent White violated IRS regulations and policies. First, they contend that Special Agent White opened the investigation based on information obtained from the McLaughlins' business competitor, Gerald Azeff, who the defendants allege is also a friend of Special Agent White, and obtained information from Bernard McGuigan, the defendants' "sworn enemy." According to the defendants, that violated IRS policy prohibiting agents from having personal relationships with "informants" and is also unfair because information obtained from the defendants' enemy or competitor is unreliable.

Second, the defendants allege that Special Agent White did not warn defendant Russell McLaughlin Jr. of his rights to counsel and to remain silent before three noncustodial interviews. The evidence at the hearing established that during the investigation, Special Agent White issued a summons demanding the production of, among other things, BIU corporate and financial records. Russell McLaughlin Jr. appeared as the corporate custodian of records, provided several boxes of documents, and answered Special Agent White's questions about them. That interview took place in Attorney Joseph P. Walheim, Esquire's office. The defendants claim that Walheim represented the defendants' father, Russell McLaughlin Sr., who was the sole target of the investigation at that time. On two other occasions, Russell McLaughlin Jr. provided documents to the IRS. While the record is, at best, unclear, I will assume for the purposes of this opinion that Russell McLaughlin Jr. was "interviewed" by Special Agent White when he provided

documents on the two other occasions. According to the defendants, the failure to warn Russell McLaughlin Jr. violated IRS policy.

Third, Special Agent White did not issue a receipt when Russell McLaughlin Jr. produced the BIU corporate and financial documents. Among other things, the IRS summons called for the production of records for a BIU account at the New Jersey National Bank. The indictment alleges that Russell McLaughlin Jr. failed to produce those records and that the account was used to conceal taxable funds received from BIU customers. That failure to issue the receipt violated IRS policy.

Fourth, the defendants claim that Special Agent White attended a meeting with his "informant," Azeff, during which Special Agent White allowed Azeff to control the meeting and ask questions of those in attendance. The evidence at the hearing established that in March, 1989, Azeff held a meeting with a state and a local official which Special Agent White attended. Following the meeting, Azeff sent an anonymous letter to the Pennsylvania Attorney General's Office accusing Russell McLaughlin Jr. of extortion and improperly influencing a Newtown Township, Pennsylvania, official. According to the defendants, Special Agent White's conduct violated IRS policy requiring agents to control "informants" and prevent them from asking questions during witness interviews.

Fifth, Special Agent White mailed to 77 municipalities IRS "circular letters" which requested financial information on some of the defendants' family businesses. Several of the recipients of the circular letters did not conduct business with the McLaughlins' companies and would, according to the defendants, possess no information relevant to the investigation

of them. None of the letters, however, mentioned any of the defendants by name. According to the defendants, this violated IRS policy requiring agents to consider how subjects of investigations will be harmed or embarrassed by issuance of the circular letters.

2. Violations of federal statutes.

The defendants also contend that Special Agent White violated federal statutes and court rules. First, the defendants claim he disclosed confidential tax return and grand jury information about them. See 26 *US.C. § 6103;* Fed.R.Crim.P. 6(e)(2). The evidence at the hearing established only that McGuigan knew Azeff was Special Agent White's "informant," that an employee of Azeff concluded that the case against the defendants had been approved in Washington, D.C., and was "waiting to go to court," and that Michael Wilfing, a state of New Jersey employee, knew the identities of the targets of the IRS investigation. Each of those individuals denied that Special Agent White provided that information and the defendants produced no credible evidence that he was the source. Second, the defendants claim Special Agent White failed to investigate allegations that McGuigan made false statements in a mortgage loan application and failed to report to the IRS that Azeff altered one of the circular letters and mailed the altered version to some of the McLaughlin family companies' customers. See 26 U S. C. § 7214(a)(8). At the hearing, the defendants failed to establish that Azeff altered the document or that Special Agent White knew that Azeff allegedly did so. Indeed, Attorney Walheim testified that he reported the incident to Special Agent White who assisted Walheim in attempting to determine who sent the altered circular letter. Finally, the defendants charge that Special Agent White obtained documents from the defendants' corporate

accountant, Melvin Cherry, and their stockbroker, McLaughlin, Piven, and Vogel, without first issuing summonses. See 26 *US.C.* §§ 7602(a)(1), 7609(a).

I will now consider the defendants' arguments that Special Agent White's conduct violated the Constitution or that dismissal of the indictment is warranted pursuant to the federal courts' supervisory power.

B. Constitutional Arguments.

The defendants claim that Special Agent White's alleged misconduct resulted in three violations of their constitutional rights. First, they contend that Special Agent White's failure to warn Russell McLaughlin Jr. violated his Fifth Amendment right to "non-custodial warnings." (See Dft.'s Reply at 19). The defendants' argument is without merit because a person has no constitutional right to warnings when he is not in custody. See, e.g., *Beckwith v. United States, 425 US. 341, 347, 48 L. Ed. 2d 1, 96 S. Ct. 1612 (1979).*[1] It is undisputed that Russell McLaughlin Jr. was not in custody during any of the interviews and there is no evidence that Special Agent White coerced or intimidated McLaughlin or otherwise acted improperly. While McLaughlin claims that Walheim represented not him, but his father, there is no reason to believe that Walheim would have sat idly by if Special Agent White had attempted to intimidate Russell McLaughlin Jr. or acted improperly and nothing to suggest that Special Agent White knew that Walheim represented only the defendants' father.

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1. Of course, defendants Mark and Robin McLaughlin have no standing to raise an alleged violation of Russell McLaughlin Jr.'s rights. See *Rakas v. Illinois, 439 US. 128, 134, 58 L. Ed. 2d 387, 99 S. Ct. 421 (1978).*

Second, the defendants contend that Special Agent White violated the Fourth Amendment's prohibition against unreasonable seizures when he obtained documents from Accountant Cherry without first issuing a summons. The evidence at the hearing, however, established that Special Agent White did not "seize" the records, but that Cherry voluntarily provided copies of them. (Tr. *9/19/95* at 65). Moreover, the defendants' voluntary provision of the records to Cherry knowing that they would be used to prepare and be incorporated into tax returns which would be viewed by others, establishes that the defendants had no legitimate expectation of privacy in them. See *Couch v. United States, 409 US. 322, 335, 34L. Ed. 2d 548, 93 5. Ct. 611 (1973).*

Third, the defendants argue that Special Agent White's alleged violation of IRS negations taken together abridged their right to due process. Failure to obey agency regulations does not violate the Constitution unless the regulations themselves are constitutionally mandated. *United States u Caceres, 440 U.S. 741, 749-50, 59 L. Ed. 2d 733, 99 S. Ct. 1465 (1979); Pa. Steel Foundry & Mach. v. Sec'y of Labor, 831 F:2d 1211, 1219 (1987).* None of the regulations at issue are constitutionally mandated. Regardless, obtaining information from the defendants' "enemies" or Special Agent White's friend, attending a meeting conducted by Azeff which Special Agent White did not sufficiently control,[2] or issuing IRS circular letters to

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2. The defendants describe the March, 1989, meeting as an interview of a witness by an IRS agent and contend that agency regulations required Special Agent White to "control" it and prevent Azeff, an "informant," from asking questions. The record does not support the defendants' characterization of the meeting. In fact, it

(Cont'd)

municipalities that did not even mention the defendants by name could not have violated even arguably any of their constitutional or statutory rights. *United States v. Payner, 447 US. 727, 733-34, 65 L. Ed. 2d 468, 100 S. Ct. 2439 (1980);* see also *Rakas, 439 U S. at 134.* Even accepting the defendants' claims, the alleged violations are all relatively insignificant and they neither singularly nor collectively amount to a violation of due process.

While the failure to warn Russell McLaughlin Jr. of his rights or issue him a receipt are somewhat closer calls, it is clear that neither omission warrants dismissal of the indictment. Even if Special Agent White violated IRS policy, he did not act in bad faith. Cf. *Arizona v. Youngblood, 488 US. 51, 57, 102 L. Ed. 2d 281, 109 S. Ct. 333 (1988).* There is no evidence that Special Agent White failed to warn Russell McLaughlin Jr. for the purpose of intimidating or coercing McLaughlin to incriminate himself or that McLaughlin was even a target of the IRS investigation. The fact that Special Agent White's questions may have gone beyond those normally directed at a custodian of records (i.e., authenticity, completeness, and chain of custody of the subpoenaed documents) does not establish bad faith. The defendants also failed to establish that Special Agent White's failure to issue the receipt was motivated by bad faith. Indeed, there is no evidence that McLaughlin requested and was refused a receipt or that Special Agent White failed to provide him one for the purpose of falsely claiming that McLaughlin did not produce the New Jersey National Bank records. The defendants

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(Cont'd)
was called by Azeff to provide to state, local, and federal officials information about allegedly criminal behavior by a Newtown Township official and Russell McLaughlin Jr. Nothing in IRS regulations would prevent an agent from attending or obtaining information from such a meeting.

argue that they are now unable to use the nonexistent receipt to prove that Russell McLaughlin Jr. produced those documents. The fact that Special Agent White did not provide a receipt does not prevent them from introducing other evidence supporting that claim.

Because I find no violations of any of the defendants' constitutional rights, I will not dismiss the indictment on that ground.

C. Supervisory Power.

I also decline to dismiss the indictment pursuant to the federal courts' supervisory power. Federal courts may, within narrow limits, formulate procedural rules not specifically required by the Constitution or federal statute. *Bank of Nova Scotia, 487 US. at 254 55.* However, exercise of that power is only appropriate when the government misbehavior violates "clear" rules designed to protect the fairness of the trial process or grand jury. See *United States v. Williams, 504 US.36, 45-46, 118 L. Ed. 2d 352, 112 S. Ct. 1735 (1992).* Courts may not exercise supervisory power on behalf of parties whose rights were not violated, *Payner, 447 U S. at 733-34,* or grant relief when a defendant is not prejudiced by the alleged misconduct. *Bank of Nova Scotia, 487 U S. at 25455.*

Strictly speaking, the leading case on the federal courts' supervisory power, Bank of Nova Scotia, is factually distinguishable from the instant case. The defendants in that case sought dismissal of an indictment based on allegations that a prosecutor engaged in improper conduct before the grand jury. See *id. at 26061;* see also *United States v. Ashland Oil Inc., 705 F. Supp. 270, 277 (WD. Pa. 1989).* In this case, there

are no allegations of improper conduct by the assistant United States attorney or that any of the alleged misbehavior occurred in front of the grand jury. Bank of Nova Scotia is instructive, however, because it teaches that the prejudice defendants are required to prove is the type that compromises the integrity of the judicial process. See also *Williams, 504 U.S. at 45-46* (federal court may exercise supervisory power only when government misconduct results in violation of "clear rule[]" designed to protect integrity of grand jury or trial process).

According to the Bank of Nova Scotia Court, a defendant is prejudiced when the misconduct "substantially influenced the grand jury's decision to indict" or when there is "grave doubt" that the decision was free from the substantial influence of the misconduct. Id. at 256. A showing of prejudice, however, is not required when "the structural protections of the grand jury have been so compromised as to render the proceedings unfair." Id. The defendants contend that they do not have to establish prejudice because Special Agent White's alleged misconduct was "pervasive." The Supreme Court has not relieved defendants of the requirement of showing prejudice except in cases where there is racial or gender discrimination in the selection of grand jurors. Id. at 256-57. Because there is no allegation that the grand jury was selected improperly or that "the structural protections of . . . [it] were compromised," the defendants must establish prejudice. See *United States v. Soberon, 929 F.2d 935, 941* (3d Cir.), cert. denied, *502 US. 818, 116L. Ed. 2d 47, 112 S. Ct. 73, 112 S. Ct. 74 (1991).*

Thus, in order to warrant dismissal of an indictment pursuant to my supervisory power, the alleged misconduct must result in some improper advantage to the government either before the grand jury or the court. Misconduct which results in

prejudice outside the judicial process, such as loss of business or personal or professional embarrassment, is not sufficient to warrant dismissal of an indictment. None of the defendants' allegations of misconduct, either alone or taken together, warrants exercise of my supervisory power.

Dismissal of the indictment pursuant to my supervisory power based on the defendants' allegations of violations of IRS regulations is not appropriate for several reasons. As detailed above, Special Agent White did not act in bad faith. Moreover, the fact that the IRS has already provided a remedy for violations of its regulations by disciplining employees who violate them makes the additional remedy of dismissal of the indictment unwarranted. See, e.g., Internal Revenue Manual ("IRM") §§ 751.12(2), 752.232(1), 752.432(1). Dismissal of an indictment may be a permissible and effective remedy in a case where the claimed misconduct is substantially more serious than that alleged in this case. Dismissing the charges against these defendants would interfere with the executive branch's function of promulgating and enforcing regulations. See *Caceres, 440 U.S. at 756.* Finally, as detailed above, most of the alleged "misconduct" did not even arguably violate any of the defendants' rights and none of it prejudiced them.[3]

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3. The closest the defendants come to alleging a violation of anyone's rights is the failure to warn Russell McLaughlin Jr. or issue him a receipt. However, IRS regulations requiring those actions are not "clear rules" aimed at protecting the integrity of the judicial process or grand jury. See *Williams, 504 US. at 45-46.* Instead, they are agency regulations designed to govern employee conduct, violations of which may result in internal agency discipline. See IRM §§ 751.12, 751.15(2). Failure to heed them, therefore, is not the type of "government misconduct" contemplated by Bank of Nova Scotia

(Cont'd)

Similarly, dismissal of the indictment is not an appropriate remedy for Special Agent White's alleged violations of federal statutes. Both Congress and the IRS have already provided other remedies for violations of those statutes. See *26 U.S.C. § 7214*(a) (providing for dismissal, fine, and imprisonment for IRS employees' failure to report revenue law violations); *18 U.S.C. § 1905* (providing for dismissal, fine, or imprisonment for disclosure of confidential return information in violation of 26 US. C. § 6103); IRM § 752.232(1) (providing for IRS discipline for statutory violations by employees); see also *United States* v. *Michaelian, 803 F.2d 1042, 1049 (9th Cir. 1986); Marvin v. United States, 732 F.2d 669, 672-73 (8th Cir.* 1984). Adding the sanction of dismissal of an indictment would thwart Congress' and the IRS' respective wills. Regardless, the defendants simply failed to establish that Special Agent White violated any federal statute. With respect to McGuigan and Azeff's alleged illegal conduct, the statute, *26 U.S.C. § 7214*(a)(8), only requires that the allegations be reported to the IRS and it is undisputed that they were. There is no evidence that Special Agent White improperly disclosed tax return or grand jury information. Even if Special Agent White committed those violations, which he clearly did not, none of them compromised the fairness of the judicial process or grand jury in any way. If they occurred, those actions may have embarrassed the defendants, but they could not possibly have "prejudiced" them within the meaning of Bank of Nova Scotia or Williams.

(Cont'd)

and Williams. Furthermore, the defendants were not prejudiced by Special Agent White's omissions because they did not give the government an improper advantage, impair the fairness of the judicial process, were not substantial influences on the grand jury's decision to indict, and do not raise a "grave doubt" about that decision.

Additionally, Special Agent White's obtaining documents from Accountant Cherry and McLaughlin, Piven and Vogel, without first issuing summonses does not violate *26 U.S.C. §§ 7602*(a)(1) and *7609*(a). There is no requirement that the IRS issue a summons every time it receives records from third parties. See *Speck v. United States, 59 F.3d 106, 108 (9th Cir. 1995)*. The defendants' reading of the statute would prevent the IRS from conducting informal investigations and mandate court intervention every time an agent seeks documents from anyone, no matter how willing to provide them that person may be. While it is true that a summons may be used to obtain documents, it does not follow that where there is voluntary compliance with a reasonable request by an IRS agent that proceeding without a summons is somehow unlawful or constitutes misconduct.

For those reasons, I will refuse the defendants' motion to dismiss the indictment pursuant to the federal courts' supervisory power.

II. The Motion to Suppress.

In the alternative, the defendants request that I suppress statements made by Russell McLaughlin Jr. during the noncustodial interviews conducted by Special Agent White and the documents provided by Accountant Cherry. Defendants Robin and Mark McLaughlin do not have standing to move to suppress Russell's statements. *Rakas, 439 US. at 134*; *Payner, 447 U.S. at 733-34*. Suppression of those statements is not warranted because none of Russell McLaughlin Jr.'s constitutional or statutory rights were violated by Special Agent White's failure to warn him and, as discussed above, there is no evidence that Special Agent White acted in bad faith or coerced or intimidated him. See *Caceres, 440 U.S. at 756*. Furthermore,

because the procurement of documents from Cherry was not improper, their suppression is not warranted.

III. The Motion to Dismiss the Superseding Indictment for Abuse of the Grand Jury.

Additionally, the defendants argue that the superseding indictment must be dismissed because it resulted from the government's improper use of the grand jury. The original indictment named only Russell McLaughlin Jr. and Mark McLaughlin as defendants. Subsequent to its return, the government presented more evidence to the grand jury and it returned the superseding indictment which included additional overt acts and named Robin McLaughlin as a defendant. The defendants contend that the obtaining of the superseding indictment shows that the government abused the grand jury process because, prior to the date of the original indictment, it was aware of the evidence against Robin McLaughlin. According to the defendants, this prior knowledge by itself establishes that the government used the grand jury improperly to conduct discovery and "freeze" the testimony of the witnesses presented to the grand jury between the return of the original and superseding indictments.

Abuse of the grand jury occurs when the government uses it for the "sole or dominant purpose" of conducting discovery or preparing for trial on a pending indictment. See, e.g., *United States v. Leung, 40 F.3d 577, 581 (2d Cir. 1994)*; *In Re Grand Jury Matter, 689 F. Supp. 454, 463 (E.D. Pa. 1987)*. The government does not abuse the grand jury process if, in addition to conducting a legitimate investigation, the government obtains additional evidence or freezes witnesses' testimony. *In Re Grand Jury Matter, 689 F. Supp. at 463*. Here, the government properly

presented evidence to the grand jury which then elected to indict Robin McLaughlin. The mere fact that the government was aware of the evidence before the grand jury returned the superseding indictment does not establish that the government violated the defendants' rights to due process. I find that the defendants failed to overcome the presumption of regularity in the grand jury's proceedings and have not met their burden of establishing any improper use by the government. See *In Re Grand Jury Proceedings, 632 F.2d 1033, 1041 (3d Cir. 1980).* Therefore, I will deny their motion.

IV. The Motion to Dismiss the Indictment Against Robin McLaughlin on Statute of Limitations Grounds.

Finally, Robin McLaughlin argues that I must dismiss the superseding indictment against her because count one, the only count in which she is named, does not allege an overt act in furtherance of the charged conspiracy within the six-year statute of limitations period.[4] She contends that the only overt acts within the limitations period, numbers seven and eight, charge "acts of concealment" which were not in furtherance of the goal or "central purpose" of the conspiracy and are, therefore, improperly charged. Because overt acts seven and eight properly allege acts in furtherance of the conspiracy charged in count one of the indictment, I will deny her motion.

Overt act seven charges that Russell McLaughlin Jr. failed to disclose the existence of the BIU bank account at New Jersey National Bank during an IRS interview conducted on October

4. Robin McLaughlin was indicted on May 11, 1995. Therefore, in order to avoid dismissal on statute of limitations grounds, the superseding indictment must allege at least one overt act after May 11, 1989.

20, 1989. Overt act eight charges that in or about early 1990, Russell McLaughlin Jr. and Mark McLaughlin lied to BIU's accountant about the nature of that bank account. The accountant, identified in the indictment as "W.S.C.," had prepared the 1988 BIU tax return. Both those alleged acts occurred within six years of the return of the superseding indictment and when the IRS was conducting an investigation of the tax liability of Russell McLaughlin Sr. and several McLaughlin family owned companies.

Specifically, count one of the indictment alleges that the defendants:

> conspired to defraud the United States by impeding, impairing, obstructing, and defeating the lawful government functions of the Internal Revenue Service . . . in the ascertainment, computation, assessment, and collection of revenue, specifically, income tax due and owing the United States from companies owned and operated by [the defendants].

(Superseding Ind. P 20). The defendants argue that the central purpose or goal of the conspiracy was achieved when the 1988 BIU return was filed on March 15, 1989. I disagree. If proven, overt acts seven and eight would have the effect of furthering the conspiracy's central purpose or goal of "impeding, impairing, obstructing, and defeating" IRS attempts to ascertain and collect the income tax due. The fact that those attempts occurred after the filing of the false tax return on March 15, 1989 is not significant.

The defendants also request that I strike overt acts one, three, four, five, seven, and eight from the indictment because

they are the result of Special Agent White's alleged misconduct. For the reasons stated in this opinion, I will refuse that motion.

V. Conclusion.

For the foregoing reasons, I will deny the defendants' pretrial motions.

An appropriate order follows.

ORDER

AND NOW, this day of December, 1995, it is ORDERED that:

1. The defendants' motion to dismiss the indictment based on government misconduct and motion to dismiss the indictment based on improper use of the grand jury are hereby DENIED.

2. The defendants' motions to suppress the statements of defendant Russell McLaughlin Jr., the documents received from accountant Melvin Cherry, and evidence received by the grand jury after March 9, 1995, are hereby DENIED.

3. The defendants' motions to dismiss the superseding indictment against Robin McLaughlin and strike overt acts 1, 3-5, 7, and 8 from the indictment are hereby DENIED.

4. The defendants' motion to compel the testimony of Internal Revenue Service Special Agents Robert W. White, Robert Tengood, and William Fredericks is hereby DENIED.

BY THE COURT:
J.

APPENDIX G — SUPERSEDING INDICTMENT IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA FILED MAY 11, 1995

UNITED STATES OF AMERICA

v.

RUSSELL MC LAUGHLIN, JR.
MARK MC LAUGHLIN
ROBIN MC LAUGHLIN a/k/a
ALICE ROBIN MC LAUGHLIN PAVLO

CRIMINAL NO. 95-113

DATED FILED 5-11-95

VIOLATIONS

18 U.S.C. § 371 (Conspiracy to defraud the United States — 1 count)
26 U.S.C. § 7201 (Attempt to evade tax — 1 count)
26 U.S.C. § 7206(1) (Subscribing a false return — 1 count)

SUPERSEDING INDICTMENT

COUNT ONE

THE GRAND JURY CHARGES THAT:

At all other times material to this indictment:

1. Russell McLaughlin, Jr., Mark McLaughlin, Robin McLaughlin and other persons known to the grand jury owned

five companies that operated in Pennsylvania, New Jersey, and Delaware, including Middle Atlantic Electrical Inspections, Inc. ("Middle Atlantic"); its subsidiary, Building Inspection Underwriters, Inc. ("BIU"); Homes Built with Pride ("Homes"); Burns Electrical Inspections, Inc. ("Burns"); and Multi-Alliance Insurance Co., Inc. ("Multi-Alliance").

2. According to Homes's federal income tax returns, R.M., whose identity is known to the grand jury, was the sole owner of Homes, which sold home warranties in Delaware.

3. The other four companies were owned by Russell McLaughlin, Jr. (15 percent); Mark McLaughlin (10 percent); Robin McLaughlin (10 percent); and two other persons whose identity is known to the grand jury; E.M. (60 percent); and B.M. (five percent).

4. BIU and Middle Atlantic inspected buildings and the electrical, plumbing, and heating systems of buildings for municipalities in the states of Pennsylvania and New Jersey, and had three offices: southern New Jersey, northern New Jersey, and Pennsylvania; gross receipts from these inspections were approximately $1.9 million in 1986, approximately $3 million in 1987, and approximately $4.2 million in 1988.

5. Burns inspected electrical systems for municipalities and contractors.

6. Multi-Alliance was designed to write general liability, property, and surety insurance for small construction contractors, with emphasis on elevator installation, maintenance, and inspection coverage, as well as home warranty programs, but was never licensed by any state to do so.

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7. Russell McLaughlin, Jr. was president of BIU.

8. Mark McLaughlin was an officer of BIU and managed the Philadelphia office.

9. Robin McLaughlin was an officer of BIU and managed the southern New Jersey office of BIU.

10. BIU had the following bank accounts: the Philadelphia office had a checking account and a savings account at First Pennsylvania Bank; the northern New Jersey office had a checking account and a money market account at Morris County Bank; the Southern New Jersey office had a checking account and a money market account at First Fidelity Bank, and, as of June, 1988, a checking account at New Jersey National Bank.

11. Homes had the following bank accounts: a checking account and a savings account at First Pennsylvania Bank, and a checking account in the name PRIDE Home Warranty Program at Delaware Trust Bank.

12. Burns had a checking account at First Pennsylvania Bank.

13. Multi-Alliance had a checking account at First Pennsylvania Bank.

14. From 1985 through 1988, M.C., a Philadelphia accountant known to the grand jury, maintained the above companies' books and prepared tax returns for BIU/Middle Atlantic (1984–1987), Homes (1986–1987), and Burns (1986–1987).

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15. In early 1989, W.S.C., a Philadelphia certified public accountant known to the grand jury, replaced M.C. as the above companies' accountant and prepared the 1988 tax returns for BIU/Middle Atlantic, Homes (June–December, 1988), and Burns.

16. W.S.C. was a partner in the accounting firm known to the grand jury, one of whose employees — J.R. and A.L. — assisted in the preparation of the above companies' 1988 tax returns.

17. All of the accounting and tax preparation work was done in the Philadelphia office, to which the other offices sent bank statements and related information for reconciliation.

18. All of the accounting and tax preparation work was done from bank statements and, in some cases, cash disbursements journals; neither accountant examined cash receipts journals or specified deposited items.

19. Both accountants, M.C. and W.S.C., considered all home warranty fee payments received by Homes to be non-taxable for the ten-year life of the home warranty; for tax purposes, they treated the warranty income as a reverse against future liability, with any proceeds remaining at the end of the ten-year period declarable as income at that time.

20. Both accountants, M.C. and W.S.C., considered all inspection income received by BIU to be taxable to BIU in the year in which it was received.

21. From in or about 1985 to in or about early 1990, in the Eastern District of Pennsylvania and elsewhere, defendants

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RUSSELL MC LAUGHLIN, JR., ROBIN MC LAUGHLIN, and MARK MC LAUGHLIN

did knowingly, willfully, and unlawfully conspire, combine confederate, and agree to defraud the United States by impeding, impairing, obstructing, and defeating the lawful governmental functions of the Internal Revenue Service of the Department of the Treasury of the United States of America in the ascertainment, computation, assessment, and collection of revenue, specifically, income tax due and owing the United States from companies owned and operated by them, under the circumstances, by the means, and in the manner set forth in paragraphs 22 through 32 of this Count.

MEANS AND METHODS

22. It was a part of the conspiracy to divert certain BIU income to other family-owned companies and to family members without declaring the income as having been received by BIU and as being taxable to BIU.

23. It was a further part of the conspiracy to deceive BIU's accountants as to the true amount of BIU's gross receipts by stating that certain items of BIU income were not BIU income, and by concealing certain items of BIU income completely.

BIU Income Deposited into Homes' Bank Account

24. It was a further part of the conspiracy that between July 24, 1985 and June 30, 1986, BIU income checks totalling approximately $195,722.81 were deposited into Homes's checking and savings accounts at First Pennsylvania Bank.

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25. It was a further part of the conspiracy that on or about August 28, 1986, defendant MARK MC LAUGHLIN sent a memorandum to accountant M.C. telling him that the BIU income checks identified in paragraph 23 were "transactions . . . to be recorded in the books of 'Homes Built with Pride' as . . . Home Enrollment Fees."

26. It was a further part of the conspiracy that as a result of the instruction from defendant MARK MC LAUGHLIN to accountant M.C., $195,722.81 in fee income was not declared as income by BIU on its federal tax returns, resulting in a loss of revenue to the Internal Revenue Service of $71,337.

1988 Receipts Diverted to a Secret Bank Account

27. It was a further part of the conspiracy that on or about June 2, 1988, defendants RUSSELL MC LAUGHLIN, JR. and ROBIN MC LAUGHLIN, together with E.M., opened a BIU corporate checking account at New Jersey National Bank, on which all three persons were authorized signers.

28. It was a further part of the conspiracy that from approximately June, 1988 through December, 1988, 18 BIU income checks, totalling $718,182.32, were deposited into BIU's checking account at New Jersey National Bank.

29. It was a further part of the conspiracy that defendants RUSSELL MC LAUGHLIN, JR., MARK MC LAUGHLIN, and ROBIN MC LAUGHLIN did not tell accountants M.C., W.S.C., J.R., or A.L. that BIU had a checking account at New Jersey National Bank, and did not provide them with bank statements for the account.

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30. It was a further part of the conspiracy that the $718,182.32 in BIU inspection fees deposited into the New Jersey National Bank checking account was not declared on BIU's 1988 tax return, resulting in a loss of revenue to the Internal Revenue Service of $244,155.

1988 Receipts Adjusted Out of Income

31. It was a further part of the conspiracy that on or about March 14, 1989, in connection with accountant W.S.C.'s preparation of BIU's 1988 tax return, defendants RUSSELL MC LAUGHLIN, JR., and MARK MC LAUGHLIN told W.S.C. that the $770,240 shown on accountant M.C.'s bank reconciliation as BIU "fee income" was not income but money they had set aside for warranty reserves, when in fact $768,827 of that amount was income to BIU that should have been declared on BIU's 1988 tax return.

32. It was a further part of the conspiracy that on or about March 14, 1989, accountant W.S.C. debited BIU's 1988 income by $770,240 as a result of the information given to him by defendants RUSSELL MC LAUGHLIN, JR. and MARK MC LAUGHLIN, resulting in a loss of revenue to the Internal Revenue Services of $306,022.

OVERT ACTS

In furtherance of the conspiracy and to accomplish its objects and purposes, defendants RUSSELL MC LAUGHLIN, JR., MARK MC LAUGHLIN, ROBIN MC LAUGHLIN, and other persons known to the grand jury committed the following overt acts, among others, in the Eastern District of Pennsylvania or elsewhere:

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1. On or about August 28, 1986, defendant MARK MC LAUGHLIN instructed accountant M.C. that certain deposits to Homes's bank accounts at First Pennsylvania Bank constituted home warranty fees, when in fact said deposits constituted payments to BIU for inspections.

2. In or about June, 1988 through December, 1988, $467.353 was disbursed from the New Jersey National Bank checking account, including $250,000 to a Butcher & Singer for investments, $160,000 to Homes, $23,000 as a loan to defendant RUSSELL MC LAUGHLIN, JR., $30,754 as loans to defendant ROBIN MC LAUGHLIN, and $3,589 for "travel and entertainment" and "cash" to defendant ROBIN MC LAUGHLIN.

3. On or about November 19, 1988, defendant ROBIN MC LAUGHLIN caused to be deposited in the New Jersey National Bank checking account a check in the amount of $73,419.80 from Lower Makefield Township addressed to Building Insp Underwriters, P.O. Box 11520, Philadelphia, PA 19116.

4. On or about December 2, 1988, defendant ROBIN MC LAUGHLIN caused to be deposited in the New Jersey National Bank checking account a check in the amount of $15,786 from Lower Makefield Township addressed to Building Insp Underwriters, P.O. Box 11520, Philadelphia, PA 19116.

5. On or about December 2, 1988, defendant ROBIN MC LAUGHLIN caused to be deposited a check in the amount of $27,175.17 from the Township of New Britain addressed to Building Inspection Underwriters, Inc., 3404 Trewigtown Road, Colmar, PA 18915.

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6. On or about March 14, 1989, defendants RUSSELL MC LAUGHLIN, JR. and MARK MC LAUGHLIN advised accountant W.S.C. that $770,240 in BIU income was not BIU income, but actually consisted of officer loans and/or investments transferred to Homes and Multi-Alliance as warranty reserves.

7. On or about October 20, 1989, in response to a request for BIU's books and records, defendant RUSSELL MC LAUGHLIN, JR. did not tell the Internal Revenue Service about BIU's New Jersey National Bank checking account, did not provide any bank statements for BIU's New Jersey National Bank account, and did not provide any other books or records showing the existence of BIU's New Jersey National Bank Account.

8. In or about early 1990, when accountant W.S.C. learned of the existence of BIU's New Jersey National Bank checking account and asked defendants RUSSELL MC LAUGHLIN, JR. and MARK MC LAUGHLIN why they had not told him about the account, defendants RUSSELL MC LAUGHLIN, JR. and MARK MC LAUGHLIN told W.S.C. that the New Jersey National Bank account was an account that they had set up as a reserve account for the payment of home warranty claims.

In violation of Title 18, United States Code, Section 371.

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COUNT TWO

THE GRAND JURY FURTHER CHARGES THAT:

On or about March 15, 1989, in the Eastern District of Pennsylvania, defendants

RUSSELL MC LAUGHLIN, JR.
and MARK MC LAUGHLIN

willfully attempted to evade and defeat the payment of a large part of the income tax due and owing by Building Inspection Underwriters Inc. ("BIU") to the United States for the calendar year 1988, by concealing and attempting to conceal from BIU's accountant and the Internal Revenue Service the nature and extent of BIU's income and the location thereof, and by making false statements to BIU's accountant with respect to the nature and extent of BIU's income.

In violation of Title 26, United States Code, Section 7201.

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COUNT THREE

THE GRAND JURY FURTHER CHARGES THAT:

On or about March 15, 1989, in the Eastern District of Pennsylvania, defendant

RUSSELL MC LAUGHLIN, JR.

did willfully make and subscribe a 1988 tax return for Building Inspections Underwriters, Inc. ("BIU"), which was verified by a written declaration that it was made under the penalties of perjury and was filed with the Director, Internal Revenue Service Center, at Philadelphia, Pennsylvania, which tax return he did not believe to be true and correct as to every material matter, in that the said tax return stated BIU's gross receipts to be $3,056,215, whereas, as he then and there well knew and believed, BIU's gross receipts were substantially in excess of that amount.

In violation of Title 26, United States Code, Section 7206(1).

A TRUE BILL:

FOREPERSON

s/ Michael R. Stiles
MICHAEL R. STILES
United States Attorney
First Assistant U.S. Attorney